

**RECOGNITION OF VARIOUS STAKEHOLDER INTERESTS IN
COMPANY MANAGEMENT**

by

IRENE-MARIÉ ESSER

submitted in accordance with the requirements

for the degree of

DOCTOR OF LAWS

at the

UNIVERSITY OF SOUTH AFRICA

PROMOTER: PROF MK HAVENGA

JUNE 2008

Dedicated to my role model and father, Christo, and to my best friend and mother, Sandra.

SUMMARY

Good corporate governance should be the cornerstone of all company management. Directors ought to know in whose interests the company should be managed. This thesis attempts to answer the following question: whose interests must be granted primacy in the management of a company?

In chapter 1 it is stated that shareholders' interests are traditionally granted primacy in the management of a company. There has, however, been a shift in public opinion towards recognition of a wider variety of interests that should be considered than only those of the shareholders. These interests include, *inter alia*, environmental interests and those of the investors, employees and consumers. This thesis thus focuses on the primary stakeholders, namely individual shareholders, creditors, employees, consumers and suppliers.

In chapter 2 a theoretical foundation is provided on the nature of a company. The different theories on the nature of a company, emphasising either shareholder primacy or stakeholder protection, are discussed. A combined new theory is proposed. It is suggested that the confusion relating to the meaning of "the company" needs to be eliminated.

Chapters 3, 4 and 5 provide an international comparison of the company law in Botswana, Australia, New Zealand and the United Kingdom. The focus falls, firstly, on directors' duties, secondly, on the question in whose interests directors should manage a company and, thirdly, on the codification of their duties.

In chapter 6 the South African position is evaluated. First, the possible stakeholders are identified and the protection currently afforded them is explained. The reports of the King Committee on Corporate Governance, the *Policy Document* on company law reform as well as the Companies Bill of 2007 are discussed. Draft clauses are

recommended to be incorporated in new company legislation to provide directors with clarity on what is expected of them.

It is the aim of this thesis to provide clarity on whose interests should receive primacy when directors manage a company. The outcome of this research should provide a clear indication to South African directors of what is expected of them and who the beneficiaries of their fiduciary duties are.

This thesis includes the law as at **30 April 2008**.

KEY TERMS

codes of best practice, codification, consumers, creditors, directors, directors' duties, employees, shareholder value, shareholders, stakeholder model, stakeholders, triple-bottom line.

ACKNOWLEDGEMENTS

My sincere gratitude is extended to my promoter Professor Michele Havenga for her valuable comments and suggestions. I should especially like to thank her for her guidance and friendship during the past three years.

I also wish to thank Professor Jean du Plessis for his hospitality and valuable assistance during my visit to Australia. He also contributed to my thinking through numerous conversations. I further want to thank him for his positive support and belief in my abilities.

Furthermore, I want to thank Mr Nico Ferreira of the University of South Africa's (Unisa) Library for his assistance in locating sources and verifying my footnotes and bibliography. I should also like to thank Diana Coetzee who attended to the editing of this thesis. I furthermore wish to thank Professors Coenraad Visser and Rena van den Bergh for their advice and support, which meant a great deal to me.

The financial assistance of the National Research Foundation (NRF) and Unisa (in terms of a Thuthuka grant) towards this research is hereby acknowledged. Opinions expressed in this thesis, and conclusions arrived at, are my own and are not necessarily to be attributed to the NRF or Unisa.

Finally, I am deeply thankful to my loving family who had so much patience with me and supported me throughout this research project. The completion of this thesis would not have been possible without them. Thank you, Mom Sandra, Tjaart, Sanet, Christo, Mom Jeanne and Dad Jan. I need to single out one person, my husband, Daniel. Thank you for all your love and understanding. You are my companion and I love you very much.

None of this would have been possible without God's grace and the talents He gave me. I thank Him from the bottom of my heart.

TABLE OF CONTENTS

CHAPTER 1 INTRODUCTION.....	1
1 INTRODUCTION	1
2 CORPORATE SOCIAL RESPONSIBILITY AND THE PROTECTION OF STAKEHOLDERS	5
2.1 Definition	5
2.2 Corporate Social Responsibility Facilitated Through Law.....	8
3 A REVIEW OF SOUTH AFRICAN COMPANY LAW	12
4 RESEARCH METHOD.....	13
5 REFERENCE TECHNIQUES.....	17
 CHAPTER 2 THEORETICAL FOUNDATION.....	 18
1 INTRODUCTION	18
2 SHAREHOLDER PRIMACY VERSUS STAKEHOLDER PROTECTION.....	20
3 THEORIES ON THE NATURE OF A COMPANY.....	25
3.1 The Contractual or Agency Theory	26
3.2 The Concession Theory	29
3.3 The Communitaire Theory.....	30
4 MODELS OF CORPORATE GOVERNANCE.....	32
5 THEORIES RECENTLY APPLIED	33
5.1 The Enlightened Shareholder Value and Pluralist Approaches	33
5.1.1 Arguments for and Against Shareholder Primacy	35
5.2 A Proposed Combined Theory Relating to the Recognition of Stakeholder Interests	37
6 CONCLUSIONS.....	40
 CHAPTER 3 THE LAW IN THE UNITED KINGDOM.....	 42
1 INTRODUCTION	42
2 HISTORICAL OVERVIEW.....	43
2.1 From Earliest Times Until the South Sea Bubble Act	44
2.2 The South Sea Bubble Act.....	45
2.3 The United Kingdom's Accession to the Common Market.....	46
2.4 From 1973 Until 2007.....	46

3	THE POSITION RELATING TO DIRECTORS' DUTIES PRIOR TO THE COMPANIES ACT OF 2006: AN OVERVIEW	49
3.1	The Fiduciary Duty of Good Faith.....	49
3.1.1	The Traditional Position: Directors' Duties Owed to Whom?	55
3.1.2	Individual Shareholders	57
3.1.3	Creditors	57
3.1.4	Employees	61
3.1.5	Consumers	64
3.1.6	The Different Interest Groups: Concluding Remarks.....	68
3.2	The Duty of Care, Skill and Diligence.....	69
4	THE STAKEHOLDER DEBATE: CORPORATE GOVERNANCE CODES, THE COMPANY LAW REVIEW PROCESS AND THE COMPANIES ACT OF 2006.....	73
4.1	The Cadbury, Greenbury and Hampel Reports.....	73
4.1.1	Background on the Reports	74
4.1.2	The Stakeholder Debate.....	79
4.1.3	Self-Regulation Versus Codification.....	80
4.2	The United Kingdom Company Law Review Process	82
4.2.1	Historical Overview	82
4.2.2	The Different Phases in the Review Process	84
4.2.2.1	The Strategic Framework	85
4.2.2.2	Developing the Framework	86
4.2.2.3	Completing the Structure.....	87
4.2.2.4	The White Papers of 2002 and 2005	87
4.2.3	The Stakeholder Debate.....	89
4.2.3.1	The Strategic Framework	92
4.2.3.2	Developing the Framework	93
4.2.3.3	Completing the Structure.....	94
4.2.3.4	The White Paper of 2005.....	95
4.2.4	Self-Regulation Versus Codification.....	95
4.2.4.1	The Strategic Framework	95
4.2.4.2	Developing the Framework	98
4.2.4.3	Completing the Structure.....	104
4.2.4.4	The White Paper of 2005 and the Companies Bill	106
4.2.5	Conclusions	111
4.3	The Companies Act of 2006	112
4.3.1	Introduction	112
4.3.2	Directors' Duties in Terms of the 2006 Companies Act	112
4.3.3	Evaluation of Section 172.....	118
4.3.3.1	Explanation of Section 172	119
4.3.3.2	Shareholder Primacy Retained	120
4.3.3.3	The Practical Application of Section 172.....	120
4.3.3.4	Conclusions on Section 172	122
4.3.4	Codification of Directors' Duties: Exhaustive or Partial?.....	123
5	CONCLUSIONS.....	124

CHAPTER 4 AUSTRALIAN LAW 127

1	INTRODUCTION	127
2	BACKGROUND	128
3	DIRECTORS' DUTIES	132
3.1	General Law Duties versus Statutory Duties	132
3.2	The Fiduciary Duty of Good Faith.....	136
3.2.1	The Traditional Position: Directors' Duties Owed to Whom?	140
3.2.2	Individual Shareholders	142
3.2.3	Creditors	143
3.2.4	Employees	146
3.2.4.1	Specific Labour Legislation	148
3.2.4.2	Corporate Governance Reports: The Position of Employees	153
3.2.4.3	Conclusions: Employees	156
3.2.5	Consumers	157
3.2.6	The Different Interest Groups: Concluding Remarks.....	159
3.3	The Duty of Care, Skill and Diligence.....	161
4	CORPORATE GOVERNANCE INITIATIVES AND THE STAKEHOLDER DEBATE	164
4.1	ASX's Best Practice Principles and Recommendations	164
4.2	The Corporate Law Economic Reform Program	169
4.2.1	Introduction	169
4.2.2	Paper 3: Directors' Duties and Corporate Governance	170
4.3	The Corporate Responsibility Report of June 2006.....	172
4.4	The Social Responsibility Report of December 2006.....	178
5	CONCLUSIONS.....	180

CHAPTER 5 THE LAW OF BOTSWANA 182

1	INTRODUCTION	182
2	THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY AND THE HARMONISATION OF CORPORATE LAWS.....	185
3	THE CASE OF BOTSWANA.....	188
3.1	The Company Law Review Process: An Overview.....	188
3.1.1	Introduction	188
3.1.2	Directors' Duties.....	193
3.1.2.1	The Companies Act of 1959.....	194
3.1.2.2	The Companies Act of 2003.....	196
3.1.3	SADC's Goal of Harmonisation: Followed or Rejected?	200
4	CONCLUSIONS.....	202

CHAPTER 6 SOUTH AFRICAN LAW	204
1 INTRODUCTION	204
2 DIRECTORS' DUTIES	208
2.1 The Fiduciary Duty of Good Faith.....	208
2.1.1 The Traditional Position: Directors' Duties Owed to Whom?	211
3 THE VARIOUS STAKEHOLDERS	213
3.1 Individual Shareholders	213
3.2 Creditors.....	216
3.2.1 Introduction	216
3.2.2 Arguments for and Against a Direct Duty Towards Creditors.....	218
3.2.2.1 Contractual Protection.....	218
3.2.2.2 Directors' Conduct	219
3.2.2.3 Traditional Company Law Principles.....	220
3.2.2.4 Sufficient Remedies Available to Creditors	221
3.2.2.5 Conclusions	226
3.2.3 A Fiduciary Duty to Creditors: Some Problems with the Construction of Such a Duty	228
3.2.3.1 Beneficiary of the Duty	228
3.2.3.2 When Does the Duty to Creditors Arise?	230
3.2.3.3 Conclusions	233
3.3 Employees.....	234
3.3.1 Introduction	234
3.3.2 Possible Methods of Protecting the Interests of Employees.....	235
3.3.2.1 Worker Participation	235
3.3.2.2 Workplace Forums	257
3.3.2.3 Collective Bargaining.....	261
3.3.3 Conclusions	263
3.4 Other Stakeholders	265
3.4.1 Introduction	265
3.4.2 Consumer Protection	266
3.4.2.1 Specific Legislation Aimed at Protecting Consumers.....	267
3.4.3 Supplier Protection	275
3.4.4 Conclusions	275
3.4.5 The Duty of Care, Skill and Diligence	276
4 THE STAKEHOLDER DEBATE: APPROACHES FOLLOWED IN THE KING REPORTS, THE POLICY DOCUMENT AND THE COMPANIES BILL OF SOUTH AFRICA.....	277
4.1 The King Reports	277
4.2 The Policy Document	284
4.3 The Companies Bill of 2007	286
4.4 Conclusions.....	289
5 CODIFICATION OF DIRECTORS' DUTIES	290

5.1	Introduction.....	290
5.2	General Arguments for and Against a Codification of Directors' Duties.....	291
5.3	Codification of Directors' Duties in the King Reports	293
5.4	Codification of Directors' Duties in the Policy Document.....	296
5.5	Codification of Directors' Duties in the Companies Bill.....	297
6	CONCLUSIONS.....	298

CHAPTER 7 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS. 302

1	REVIEW OF RESEARCH CONDUCTED	302
2	FINDINGS AND CONCLUSIONS	305
2.1	A Theoretical Foundation	305
2.2	Recommendation: A Proposed Combined Theory	306
2.3	The Law in the United Kingdom	307
2.3.1	Stakeholder Protection and the Codification of Directors' Duties	308
2.3.2	Protection Afforded Stakeholders	309
2.4	Australian Law	311
2.4.1	Stakeholder Protection and the Codification of Directors' Duties	311
2.4.2	Protection Afforded Stakeholders	312
2.5	Harmonisation of Business Laws in SADC with Specific Reference to the Position in Botswana.....	313
2.6	South African Law	314
2.6.1	Stakeholder Protection and the Codification of Directors' Duties	314
2.6.1.1	Clauses Recommended for Future Company Legislation.....	315
2.6.2	Protection Afforded Stakeholders	321

BIBLIOGRAPHY 324

JOURNAL ARTICLES	324
BOOKS AND THESES.....	355
TABLE OF STATUTES, CODES AND BILLS.....	365
AUSTRALIA	365
BOTSWANA	365
GERMANY	365
MAURITIUS	366
NEW ZEALAND.....	366
RHODESIA	366
SOUTH AFRICA.....	366
SWAZILAND.....	367
UNITED KINGDOM	367

TABLE OF CASES	368
AUSTRALIA	368
CANADA.....	370
ENGLAND	370
NEW ZEALAND.....	373
SOUTH AFRICA.....	373
UNITED STATES OF AMERICA.....	375
REPORTS.....	376
AUSTRALIA	376
NEW ZEALAND.....	378
SADC AND BOTSWANA.....	378
SOUTH AFRICA.....	378
UNITED KINGDOM	379
OTHER REFERENCES	383
FURTHER READING	383
 INDEX.....	 389

CHAPTER 1

INTRODUCTION

- 1 INTRODUCTION**
 - 2 CORPORATE SOCIAL RESPONSIBILITY AND THE PROTECTION OF STAKEHOLDERS**
 - 3 A REVIEW OF SOUTH AFRICAN COMPANY LAW**
 - 4 RESEARCH METHOD**
 - 5 RESEARCH TECHNIQUES**
-

1 INTRODUCTION

A company is a legal entity separate from its management and shareholders.¹ The directors, who are normally responsible for managing the company, have various duties and responsibilities. They are allowed a measure of discretion when exercising these duties, which include onerous fiduciary duties, and obligations of care and skill in terms of the common law; various statutory duties in terms of the Companies Act;² and the duties imposed by the articles of association or in a separate agreement. Directors' fiduciary duties entail that they must act in good faith and in the best interests of the company as a whole.³ This obligation and its scope are considered in this thesis.

¹ The words "company" and "corporation" are both used and the same meaning should be denoted to these terms.

² Act 61 of 1973 (hereafter the Companies Act). See, for example, ss 234–241 in respect of directors' duties and specifically the duty to disclose an interest in a material contract of the company. Section 234 concerns the duty of a director to disclose any interest in a contract, s 235 describes the manner and time of such disclosure, s 237 states when the particulars of interest should be stated in the notice to a meeting and s 240 concerns the register of interests. See Henochsberg *Commentary on the Companies Act* 409–455.

³ Farrar & Hannigan *Company Law* 380; Du Plessis "Direkteure se Pligte Teenoor Partye Anders as die Maatskappy" 378–392; Havenga "The Company, the Constitution and the Stakeholders" 134; Havenga *Fiduciary Duties of Company Directors* 2, 25; Cilliers & Benade *Corporate Law* 139; Pennington *Company Law* 709; Davies *Gower and Davies' Principles of Modern Company Law* 371; Mongalo "The Emergence of Corporate Governance" 176–177; The *Policy Document for Corporate Law Reform, SA Company Law Reform for a 21st Century* May 2004 available at www.polity.org.za/pdf/notice (accessed 20 April 2007) (hereafter the *Policy Document*) and the Draft South African Companies Bill of February 2007. At the time of writing it was anticipated that the Companies Bill would be submitted to Cabinet during May 2008. This version will subsequently be

The duty of care and skill is discussed in the South African,⁴ United Kingdom⁵ and Australian⁶ chapters for the sake of completeness when discussing directors' duties. It is important that directors exercise the necessary care and skill when acting in the best interests of the company. This duty is, however, not the focus in this thesis and is therefore not discussed when considering the various corporate governance initiatives, company law review documents, Bills and legislation in the different jurisdictions. The fiduciary duty of good faith, and specifically in whose interests directors should manage a company, is the focus.

Shareholders' interests are traditionally granted primacy in the management of a company. Thus the function of directors is that of profit maximisation for the shareholders.

There has, however, been a shift in public opinion towards recognition of a wider variety of interests that should be considered than only those of the shareholders.⁷ The wider variety of interests includes, *inter alia*, environmental concerns and the interests of the following stakeholders: investors, employees, consumers, the general public and the environment. This thesis focuses on the primary stakeholders, namely individual shareholders, creditors, employees, consumers and suppliers.⁸ These stakeholders have an interest in the way the company is managed by the directors. The Constitution⁹ and other legislation also compel consideration of their interests.

submitted to the State Legal Advisors and should be introduced to Parliament by June 2008. The second version was not publicly available when this thesis was finalised, and the discussion in this thesis is therefore restricted to the aspects contained in the Draft Bill of 2007. (I did contact the Department of Trade and Industry requesting a copy of the amended version of the Draft Companies Bill of 2007 for research purposes, but they declined my request.)

⁴ Chapter 6 par 3.4.5 below.

⁵ Chapter 3 par 3.2 below.

⁶ Chapter 4 par 3.3 below.

⁷ Havenga "Directors' Fiduciary Duties Under our Future Company-law Regime" 314.

⁸ This thesis focuses on the protection that these stakeholders receive in legislation other than company legislation. These stakeholders may also be protected in terms of general common law, but this is not considered further.

⁹ See the Constitution of the Republic of South Africa, 1996 (hereafter the Constitution).

Shareholders have a permanent stake in the profits of the business, whereas creditors provide loan capital to the company. Shareholders usually receive a fixed income from their investment and invest for a limited period. Their interests are often secured. The interests of employees lie in job security. Consumers and the general public are concerned with the company as a source of products and services. Suppliers (as a special type of creditor) are concerned with timely payment for their services. Increasingly, social, safety, health and environmental factors have been advanced as issues to be considered by company management. The so-called triple-bottom line approach¹⁰ embraces not only financial performance, but also imposes social responsibility on companies.¹¹

Two important schools of thought relating to the question of in whose interests the company should be managed are the enlightened shareholder value and pluralist approaches.¹² In the enlightened shareholder value approach the primary role of the directors is seen as the promotion of the success of the company for the benefit of the company as a whole and to generate maximum value for shareholders.¹³ This conclusion is based on the “too many masters” argument; namely if more stakeholders were recognised in whose favour the duties of directors had to be exercised, the various stakeholder groups would have to be identified, and the nature and the extent of directors’ duties and responsibilities to each of them would have to be determined. The result would be that directors would not effectively be held

¹⁰ The “triple-bottom line” refers to economic, social and environmental factors. Directors should consider all three of these factors when they manage a company. See the *King Report on Corporate Governance for South Africa 2002* (hereafter *King II*) at 11 par 17.3 and s 4 ch 4. See also the *Executive Summary of King II* at par 17 available at http://www.eccg.org/codes/country_document/south_africa/executive_summary.pdf. (accessed 10 May 2007) (hereafter the *Executive Summary of King II*).

¹¹ Crook “The Good Company” 1–18; Freemantle & Rocky *The Good Corporate Citizen* 7. See par 2 below for a discussion of the concept of social responsibility.

¹² See ch 2 par 3 for a discussion of the different theories relating to stakeholder protection. These terms were used during the company law reform processes in South Africa and the United Kingdom.

¹³ Chapter 2 par 5.1; Dawson “Acting in the Best Interest of the Company” 81; Havenga “The Company, the Constitution and the Stakeholders” 135 where she refers to the Berle–Dodd debate as summarised in Hodes “The Social Responsibility of a Company” 485; Sheikh “Introduction to the Corporate Governance Themed Issues” 267, 268; Cheffins “Teaching Corporate Governance” 515–525; the *Policy Document* ch 3 par 3.2.2.

accountable to anyone, since there would be no clear yardstick for judging their actions.¹⁴

The second school is that of pluralism, which sees shareholders as one constituency among many and recognises the interests of various groups.¹⁵ Thus, a company's existence and success are regarded as intertwined with the consideration of the interests of its employees and other potentially qualifying stakeholders in the business, such as suppliers and customers.¹⁶

The aim of this thesis is to determine in whose interests directors must manage the company when they exercise their fiduciary duties. In order to achieve this aim, I attempt to answer the following question and address the related issues from a legal perspective: should directors manage the company for the benefit of only the shareholders, or should they consider a wider variety of interests?¹⁷ If directors should consider the interests of other groups, then it must be determined whether they have a direct duty to those groups to consider their interests, thus changing the traditional viewpoint that directors must manage the company for the benefit of the company as a whole. Alternatively, it could be that the directors may consider the interests of other groups, but only when so directed in terms of the Constitution or related legislation and in circumstances where it will be in the best interests of the shareholders collectively.

A further aim of this thesis is to determine whether directors' duties should be codified in a comprehensive or partial manner in order to provide directors with clear guidelines regarding their fiduciary duties.

¹⁴ Proctor & Miles "Duty, Accountability and the Company Law Review" 21.

¹⁵ Sealy "Directors' Wider Responsibilities" 173; Dean "Stakeholding and Company Law" 66; Miles "Company Stakeholders" 56; the *Policy Document* ch 3 par 3.2.2. See further ch 2 par 5.1.

¹⁶ Havenga "The Company, the Constitution and the Stakeholders" 173; the *Policy Document* ch 3 pars 3.2.1–3.2.2; Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection" 9.

¹⁷ See Lombard *Directors' Duties to Creditors*; Anderson *Corporate Directors' Liability* in which the focus is on one stakeholder group, namely creditors. See ch 6 par 3.2 for a detailed discussion of this aspect.

2 CORPORATE SOCIAL RESPONSIBILITY AND THE PROTECTION OF STAKEHOLDERS

2.1 Definition

As stated above, social, safety, health and environmental factors have been introduced as important factors to which company management must have regard. This thesis focuses on the protection of different stakeholders by directors when they manage a company. Commentators have widely divergent views on corporate social responsibility and how directors should give effect to it when managing a company.¹⁸ A theoretical foundation for shareholder primacy and the protection of stakeholders' interests is provided in chapter 2, which is a discussion of the different theories and models of corporate governance.¹⁹

A company is said to be socially responsible when directors manage a company in such a way that the company “voluntarily expends its resources to do something not required by law and without immediate economic benefits”.²⁰ Mayson et al.²¹ state that “corporate social responsibility is the responsibility of each company for its effect on the society in which it operates”.²² Parkinson states that “every large

¹⁸ On corporate social responsibility, see Pettet's analysis in “The Stirring of Corporate Social Conscience” of whether the law should assume that the sole purpose of a company is to make as much money as possible for the shareholders or whether it should propose that the corporation also has major responsibilities to its customers, its workers and its community; and Vettori *Alternative Means to Regulate the Employment Relationship* ch 9 on the meaning of corporate social responsibility.

¹⁹ Chapter 2 pars 2–5 below.

²⁰ Per Gavin Relly in Hodes “The Social Responsibility of a Company” 468. See also McBarnet et al. “Corporate Social Responsibility” 1–37.

²¹ Mayson et al. *Company Law* 30.

²² Three documents dealing with corporate social responsibility were issued in the United Kingdom: *Business and Society: Developing Corporate Social Responsibility in the UK* (URN 01/720) (2001); *Business and Society: Corporate Social Responsibility Report* (URN 02/909) (2002) *Corporate Social Responsibility: A Government Update* (2004). These reports were issued by the Department of Trade and Industry of the United Kingdom and deal with the priorities of government relating to corporate social responsibility. Their priorities include the following: to raise the profile and highlight the importance of corporate social responsibility; to make responsible behaviour a consideration of core business; and to promote transparency in corporate social responsibility. A number of recommendations on how socially responsible behaviour can be improved were listed. These recommendations include implementing a Corporate Social Responsibility Academy to train directors to act socially responsible, engaging institutional investors on recognition of the impact of social and environmental factors on long-term business performance and encouraging CSR reporting. Not much

corporation should be thought of as a social enterprise, that is, an entity whose existence and decisions can be justified only in as far as they serve public or social purposes”.²³ He suggests that company directors should take some social responsibility for the decisions they make when managing a company. He refers to this suggestion as “profit-sacrificing social responsibility”.²⁴ However, he states that “profit-sacrificing social responsibility” may lead to an increase in profitability over the long-term.²⁵ Parkinson believes that the duty on directors and the internal structures of major companies should be altered to take account of stakeholders’ interests beyond that required of directors in terms of the law. By creating favourable relations with other stakeholders, profits would also increase.²⁶ He proposes the following: that the fiduciary duties of directors should be extended to include interests other than merely the shareholders; the social costs the company is inflicting should be disclosed; consultation with local communities and consumer bodies should be mandatory; and representatives of other interest groups should be introduced onto the board of directors.²⁷

Alcock has an opposing viewpoint.²⁸ He states that the recognition of all stakeholders in an enterprise sounds attractive, but to allow directors to take into consideration all

has come from these reports, see Mayson et al. *Company Law* 30. However, section 172(1) of the new Companies Act of 2006 addresses stakeholder interests, see ch 3 par 4.3.3 below.

²³ Parkinson *Corporate Power* 23 where he quotes RA Dahl “A Prelude to Corporate Reform” in Heilbroner RL, London P (eds) *Corporate Social Policy* (1975) at 18.

²⁴ Parkinson *Corporate Power* 261.

²⁵ Parkinson *Corporate Power* 261. See also McCabe “Are Corporations Socially Responsible” 4 (corporate social responsibility relates to management doing “good works”, but does not mean that they should disregard profit maximisation altogether); Wedderburn “The Social Responsibility of Corporations” 4–6 he says that the justification for businesses is a “single-minded pursuit of profit maximisation”, but managers’ pursuit of short-term profit maximisation is realistically tempered by the need to ensure the future viability of the corporation by having a social responsibility to a wide variety of stakeholders; Slaughter “Corporate Social Responsibility: A New Perspective” 321 holds that what is considered to be socially responsible conduct is often also good for businesses over the long-term because it will increase a company’s reputation which may result in profit maximisation.

²⁶ Parkinson *Corporate Power* 261ff.

²⁷ Parkinson *Corporate Power* chapters 8 and 12. See also ch 6 par 3.3.2.1 below on the two-tier board structure applicable in Germany.

²⁸ Alcock “Corporate Governance: A Defence for the Status Quo” 898.

stakeholders' interests, the scope of directional discretion has to be widened. This will mean that structural checks and balances would have to be implemented to counteract widened powers of directors.²⁹ He argues further that a firm that operates according to a board where various stakeholders are represented is a "recipe for disaster".³⁰ He refers to Hansmann³¹ who points out that homogeneity of interests represented on the board of directors lessens decision costs.

Beuthin also discusses the issue of corporate social responsibility and specifically in whose interests directors should manage the company. He refers to the *Savoy Hotel*³² case where counsel advised the directors that they should manage the company in the best interests of both present and future members. He then refers to the well-known case of *Ford Motor Company*, where Henry Ford tried to take the interests of other stakeholder groups into account and to ignore the interests of the shareholders:

‘My “ambition”,’ said Ford, ‘is to employ still more men to spread the benefits of this individual system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back into the business.’³³

These proposals were rejected by an American court (Michigan Supreme Court) which stated that the directors were not entitled to conduct the affairs of the company for the mere incidental benefit of the shareholders.³⁴

Hodes discusses various theories relating to social responsibility.³⁵ The functional theory holds that the function of business is to provide necessary goods and services

²⁹ Alcock "Corporate Governance: A Defence for the Status Quo" 912.

³⁰ Alcock "Corporate Governance: A Defence for the Status Quo" 907.

³¹ Hansmann "Ownership of the Firm" 279.

³² This case never reached the courts. See Beuthin "The Range of a Company's Interests" 157.

³³ Beuthin "The Range of a Company's Interests" 157.

³⁴ *Dodge v Ford Motor Company* 170 N.W. 668 (Mich 1919). The real problem is, however, whether or not directors can take account of the interests of other stakeholders in addition to those of the shareholders. See Beuthin "The Range of a Company's Interests" 158.

³⁵ Hodes "The Social Responsibility of a Company" 486–492.

to consumers at a reasonable profit for the suppliers. If these tasks are performed well, society will benefit. The pragmatic theory determines that the bigger the dividend, the more the shareholders will receive. By rendering good services and maintaining high profits, a company will improve its commercial service and the community will benefit. According to the social theory, there should be no need for companies to concern themselves with social responsibility, since it is the government's responsibility.

2.2 Corporate Social Responsibility Facilitated Through Law

The above-mentioned assumption that corporate social responsibility is voluntary and that it relates to a company extending its resources to do what is not required by law merits further attention. Other legislation, such as the South African Broad Based Black Economic Empowerment Act or Labour Relations Act,³⁶ can still be used to facilitate socially responsible conduct by directors. The role of legislation and other forces facilitating socially responsible conduct is considered by McBarnet.

McBarnet discusses corporate social responsibility beyond law, through law and for the law. She states that corporate social responsibility is traditionally characterised as a voluntary act by companies to do more than what is legally required of them. However, she argues that corporate social responsibility is no longer merely a voluntary act due to external and market forces requiring companies to act in a socially responsible manner beyond that required of them in terms of legislation. These forces include, first, non-governmental organisations (NGOs) that put pressure on companies to adopt policies on corporate social responsibility and, second, protests by civil societies on certain practices of companies (see, for example, the campaign against Nike and their use of cheap labour).³⁷

McBarnet argues further that law also plays an important role in enforcing corporate socially responsible behaviour. Governments are fostering corporate social

³⁶ The Labour Relations Act 66 of 1995 (hereafter the Labour Relations Act) and the Broad Based Black Economic Empowerment Act 53 of 2003 (hereafter the Black Economic Empowerment Act).

³⁷ See McBarnet et al. "Corporate Social Responsibility" at 4ff.

responsibility through indirect regulation. The pension regulation in the United Kingdom is a case in point. This legislation requires pension companies to state how they complied with social, environmental and ethical issues. It does not place an enforceable obligation on companies to do this, but merely states that companies should disclose whether they did consider social, environmental and ethical issues when making business decisions.³⁸ McBarnet states that corporate social responsibility can no longer be seen as merely voluntary. First, external and market forces are “pushing” companies to act in a responsible manner. Second, governments also enforce corporate social responsibility, sometimes in a subtle and indirect manner, through legislative regulation.³⁹ She states that “what is emerging in the area of CSR is a complex interaction between government, business and civil society”.⁴⁰

With legislation indirectly compelling companies to act in a socially responsible manner, one can no longer describe corporate social responsibility as merely a voluntary act. If corporate social responsibility is still regarded as voluntary and legislation compels certain socially responsible behaviour, would companies have to do even more to be socially responsible? In other words, do they have to do more than what the legislation compels? And if so, how would this be determined? I propose a definition of corporate social responsibility that takes legislation that indirectly compels directors to act socially responsible into account. Thus corporate social responsibility should rather be aimed at social conduct where stakeholders’ interests are taken into account, be it by way of indirect legislation or by way of voluntary conduct.

Various corporate governance initiatives and legislation facilitating corporate social responsibility and the recognition of stakeholders’ interests are discussed in this thesis.

³⁸ The Pension Act of 1995. This disclosure requirement was added to this Act during July 2000.

³⁹ McBarnet et al. “Corporate Social Responsibility” at 18ff.

⁴⁰ McBarnett et al. “Corporate Social Responsibility” at 37.

When discussing the law in the United Kingdom in chapter 3 section 172(1) of the United Kingdom Companies Act of 2006 is evaluated.⁴¹ This section is another example of where socially responsible behaviour is facilitated through legislation. In terms of this section, directors should have regard to a number of factors when managing a company, such as the interests of the company's employees, and the impact of the company's operations on the community and the environment.⁴² However, the stakeholders listed in this section, other than the shareholders, will not have standing to compel directors to take their interests into consideration, unless it can be established that the interests of the company itself were contravened.⁴³ It is within the specific director's discretion when to consider the interests of the various stakeholders listed.

Various reports, such as *ASX's Best Practice Recommendations and Principles*⁴⁴ and the *Corporate Responsibility Report*,⁴⁵ have also been issued in Australia. Chapter 4 of this thesis explains that listed companies should ensure that stakeholders are aware of decisions made by management in terms of *ASX's Principles and Recommendations*. This should be included in a company's code of conduct. Non-listed companies should also strive to keep stakeholders informed. In chapter 4⁴⁶ it is, furthermore, indicated that the *Corporate Responsibility Report* defines "corporate responsibility" as implying that companies take an "enlightened" approach to consider the interests of company stakeholders.⁴⁷

⁴¹ Chapter 3 par 4.3.3.

⁴² See ch 3 par 4.3.3 below for an evaluation and discussion of s 172.

⁴³ This will have to be done by way of a shareholder derivative action (in terms of the derivative action in ss 260–264 of the United Kingdom Companies Act of 2006). See ch 3 par 4.3.3 below.

⁴⁴ The *Australian Stock Exchange (ASX) Corporate Governance Council: Principles of Good Governance and Best Practice Recommendations* (March 2003 and August 2007).

⁴⁵ Issued by the Australian Parliamentary Joint Committee on Corporations and Financial Services during June 2006.

⁴⁶ Chapter 4 par 4.3 below.

⁴⁷ See ch 2 par 2.7 of the report.

Section 130, which codifies directors' duties in terms of the new Botswana Companies Act is evaluated in chapter 5 to determine whether directors should consider stakeholders' interests when managing a company.⁴⁸

It is argued in chapter 6 that the current Companies Bill of South Africa is unclear as to whether or not directors should consider the interests of stakeholders when they manage a company, or whether directors should only have regard to the shareholders as primary beneficiaries of their duties.⁴⁹ The *King Report on Corporate Governance* of 2002 does, however, recommend that companies adopt a "triple-bottom line" approach when managing companies.⁵⁰

It is therefore generally accepted that modern companies cannot ignore their social responsibility. Social responsibility is based upon the concept of good citizenship. A company has a duty to society beyond that of an ordinary citizen due to its power and size and the benefits associated with its status as a separate legal entity,⁵¹ and should therefore recognise its social role.⁵² The unique South African context, including the best interests of its citizens and the mandates of the Constitution, cannot be ignored.⁵³ The Constitution enshrines the rights of dignity, equality and freedom in respect of all people.⁵⁴ All law, including company law, should comply with the values and requirements of the Constitution and related legislation.⁵⁵ In view of the fact that companies should be socially responsible, directors need to be clear on what is expected of them and specifically on how they should give effect to corporate social responsibility.

⁴⁸ Chapter 5 par 3.1.2.2.

⁴⁹ Chapter 6 par 4.3 below.

⁵⁰ *King II* par 17.1.

⁵¹ Havenga "Directors' Fiduciary Duties Under Our Future Company-law Regime" 312ff.

⁵² Hodes "The Social Responsibility of a Company" 490.

⁵³ *Policy Document* ch 2 par 2.2.2.

⁵⁴ Sections 9, 10 and 12 of the Bill of Rights in the Constitution.

⁵⁵ *Policy Document* ch 2 par 2.2.2. The principles of the Constitution are reflected in recently enacted legislation, for example, the Labour Relations Act; the Promotion of Access to Information Act 2 of 2000 (hereafter the Promotion of Access to Information Act); the Black Economic Empowerment Act.

3 A REVIEW OF SOUTH AFRICAN COMPANY LAW

South African company law is based on foundations that originated in the middle of the nineteenth century in England. The current South African Companies Act of 1973 is still based on a framework and general principles derived from English Law.⁵⁶ These principles were questioned in the land of its origin during a major review of the United Kingdom's company law in 2002 and 2003.⁵⁷

In May 2004 the Corporate Regulation Division of the Department of Trade and Industry issued a policy document with guidelines for a comprehensive review of South African corporate law.⁵⁸ It envisaged a review of South African corporate laws, including the Companies Act, the Close Corporations Act⁵⁹ and the common law relating to these corporate entities.⁶⁰ The protection of the interests of different

⁵⁶ Company law has existed in South Africa since 1861. It began with the Joint Stock Exchange Companies Limited Liabilities Act 23 of 1861 of the Cape Colony. This was identical to English legislation. In 1926 the first national companies legislation was introduced with the Union Companies Act. This Act has been supplemented from time to time by amending Acts. A commission (chaired by Mr Justice Lansdowne) was appointed to consider amendments to the 1926 Act, in view of new developments in English company law. The Companies Amendment Act 23 of 1939 was passed. The Companies Amendment Act 46 of 1952 was promulgated after a report of the Millin Commission. In 1963 the Van Wyk De Vries Commission was appointed and its recommendations led to the Companies Act of 1973. A standing advisory committee was established (s 18 of the Companies Act). The committee makes recommendations from time to time regarding amendments to company law. It issued a major policy document in 1985 on future developments in company law. In 1997 the Standing Advisory Committee issued an important press statement through the Department of Trade and Industry on the development of entrepreneurial law in South Africa. Five principle statutes were envisaged in terms of the strategic framework. See Cilliers & Benade *Corporate Law* 23–28. The Department of Trade and Industry has moved away from this plan. See also the *Policy Document* ch 2 par 2.1; De La Rey “Vroeë Maatskappyereg” 18–24.

⁵⁷ The *Policy Document*, foreword by the Minister of Trade and Industry, M Mphahlele; De Lacy *The Reform of United Kingdom Company Law* 3–43, 43–57, 147–178; Goddard “Modernising Company Law” 402–424; generally, www.dti.gov.uk. See the United Kingdom's Companies Act of 2006 (which received assent on 8 November 2006). This Act was partially implemented in 2007. See www.publications.parliament.uk for the Minister of Industry and Regions statement on which provisions in the Act came into force during January 2007 and which came into force during April 2007. The remainder of the provisions will be in force by October 2009. The United Kingdom Companies Act is applicable in England, Scotland, Wales and Northern Ireland. See further ch 3 par 1.

⁵⁸ See generally, the *Policy Document*. See ch 6 par 4.2 for a detailed discussion of the *Policy Document*.

⁵⁹ Act 69 of 1984.

⁶⁰ The review does not include partnership law. The review process aims to identify the fundamental rules regarding procedures for company formation, corporate finance law, corporate governance, mergers and acquisitions, the cessation of the existence of a company, and the administration and enforcement of the law.

stakeholders, such as shareholders, creditors and employees, were seen as fundamental to the review process.⁶¹ In February 2007 the Companies Bill was published. It provides that directors should act honestly and in good faith, and in a manner the directors reasonably believe to be in the best interests, and for the benefit of the company.⁶² The Bill also provided for a partial codification of directors' duties. This thesis focuses on these issues.

4 RESEARCH METHOD

Chapter 2 provides a theoretical foundation, which is relevant to the remainder of this thesis. Shareholder primacy and the protection of stakeholders are discussed in this chapter. Theories relating to the nature of a company and models of corporate governance are then considered. A proposed combined theory on the protection of stakeholders is recommended.

An international comparison is provided in chapters 3, 4 and 5.⁶³ The United Kingdom, Botswana and Australia are the area of focus. However, when discussing

⁶¹ For a concise synopsis of the *Policy Document* see Pretorius "The Future of South African Company Law" 66.

⁶² Clause 91(1)(b) of the Companies Bill 2007. See ch 6 par 4.3 for a discussion of this.

⁶³ Comparative law can be defined as a reciprocal comparison of different legal systems and legal rules with a view to obtaining new critical insights; see Zweigert & Kötz *An Introduction to Comparative Law* 1–63. They say that comparative law can be practised on a large or small scale. When it is done on a large scale (macro comparison) a comparison is made between methods of handling legal problems, such as comparing different techniques of regulation. When comparing specific legal problems (e.g. whether or not a certain person will be liable in a specific situation) one has to do with micro comparison. See Zweigert & Kötz *An Introduction to Comparative Law* 4ff and De Cruz *Comparative Law* 227ff on micro and macro comparisons. When comparing the laws in the countries chosen and trying to determine whether directors have a duty to stakeholders when managing a company one has to do with micro comparison. But when evaluating the views of different countries on the codification of directors' duties one is comparing the laws and practices of the different jurisdictions on a larger or macro scale. When conducting comparative research, one should have regard to the various sources of law. Generally, in civil law countries codes and legislation are the primary legal sources, whereas case law is more important in common law countries. A general knowledge of the structure of the specific legal system as well as the social environment is also important (see De Cruz *Comparative Law* 26). See further David & Brierley *Major Legal Systems* which provide an introduction to comparative law. Comparative legal studies are also done with specific objectives in mind. One of the aims is to determine whether a comparative system will enable a better understanding of a specific legal system and whether it offers solutions to situations which are unclear in the specific legal system (see Havenga *Fiduciary Duties of Company Directors* 4).

the protection afforded employees in terms of South African company law, the *Corporate Governance Code for Listed German Corporations* is also relevant and discussed.⁶⁴ General international codes or sets of principles on corporate governance, such as the *OECD Principles*,⁶⁵ are not discussed in this thesis.

⁶⁴ This code was adopted in February 2001. The two-tier German board structure is compared with the unitary South African board structure. See ch 6 par 3.3.2.1 below.

⁶⁵ The Organisation for Economic Co-Operation and Development (OECD) consists of a group of 30 member states sharing a commitment to a democratic government and a market economy. The original Convention on the Organisation for Economic Co-Operation and Development was signed on 14 December 1960 (see www.oecd.org). It is important to note, for purposes of this thesis that Australia ratified the Convention on 7 June 1971 and the United Kingdom ratified it on 2 May 1961. South Africa and Botswana are not member states of the convention. The aim of the convention is to: “promote policies designed (a) to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy; (b) to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and (c) to contribute to the expansion of world trade on a multilateral, non discriminatory basis in accordance with international obligations” (see art 1 of the Convention). One of their projects was to develop a set of corporate governance principles. The first set of corporate governance principles was published in 1999. The idea was that these principles can be applied in OECD as well as non-OECD countries. These principles should be interpreted as a minimum set of principles and not one single corporate governance model for OECD countries. In 2004 another set of more defined principles were published and accepted by the OECD countries. The document containing the OECD Principles is divided into two parts. The first part contains the core principles and the second contains commentary on the principles, facilitating a clear understanding of the principles. The principles in the first part ensure a basis for effective corporate governance, it also deals with shareholder rights and key ownership functions, the role of stakeholders, disclosure and transparency and the responsibilities of the board. Part IV relates to the role of stakeholders in corporate governance. It states the following: “The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.” This principle on the role of stakeholders is discussed in the second part of the OECD Principles. The drafters start by stating that corporations should realise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is important to note that the different OECD countries follow different models of corporate governance. Some of these countries are more in favour of the stakeholder model, whereas others favour the shareholder model. The principles are therefore broad corporate governance principles and should be adapted for the specific country. The drafters do not state which model is best to follow. To explain this a bit further: when the drafters refer to the position of employees, they state that employee practices depend on national laws and practices. Different mechanisms are in place in various countries to protect employees, for instance, by way of participation on board level or through works councils. The drafters do not indicate which method of employee participation they prefer, they rather provide broad principles, stating that employees should receive adequate information in order to participate meaningfully in company decisions. The aim of these principles is to assist governments in their efforts to evaluate and improve the legal, institutional and regulator framework concerning corporate governance. The drafters do not favour a specific model of corporate governance. On the OECD Principles see Du Plessis et al. *Principles of Contemporary Corporate Governance* 179–180.

In chapter 3 the law applicable in the United Kingdom is reviewed⁶⁶ and stakeholder protection is discussed. The company law review processes and the Companies Act of 2006 of the United Kingdom are discussed and evaluated. The main reason for considering this jurisdiction is that South African company law is largely based on the English system.⁶⁷ Furthermore, the recent review of company law in the United Kingdom may provide useful guidelines for the South African company law review.⁶⁸ The objectives, principles and opinions of the drafters in the various company law review documents are not unique to the United Kingdom, but important for any country to consider in order to compete in the international business community.⁶⁹

Chapter 4 considers corporate law in Australia. The company laws in Australia are based on English law. Australian company laws were also subject to comprehensive reviews, which led to considerable deviation from English law.⁷⁰ The developments in this jurisdiction may therefore contain important guidelines for South African company law.

In chapter 5 developments in the Southern African Developmental Community (SADC) are considered, with specific reference to Botswana.⁷¹ It is important to consider the laws in SADC countries, because their circumstances are similar to those

⁶⁶ The United Kingdom Companies Act of 2006 is applicable in England, Wales, Scotland and Northern Ireland. See ch 3 n 2 where the application of the 2006 Companies Act is discussed.

⁶⁷ The *Policy Document*, foreword. The fiduciary obligation, as a legal principle, originated in the English rules of equity (ch 3 par 3.1).

⁶⁸ See, for example, the *Report of the Committee on the Financial Aspects of Corporate Governance* chaired by Sir Adrian Cadbury 1992 (hereafter the *Cadbury Report*); *Directors' Remuneration Report: Report of a Study Group* chaired by Sir Richard Greenbury 1995 (hereafter the *Greenbury Report*); *Report of the Committee on Corporate Governance Final Report* 1998 (hereafter the *Hampel Report*); *Modern Company Law for a Competitive Economy: Final Report Volume 1 and 2* URN 01/942 and URN 01/943 released in July 2001 (hereafter the *Final Report*); *Modernising Company Law: The White Paper* March 2005 (hereafter the *White Paper 2005*). See ch 3 for the position in the United Kingdom. One of the main aims of comparative law is to aid the legislator, see Zweigert & Kötz *An Introduction to Comparative Law* 15.

⁶⁹ Du Plessis "Corporate Governance" 81.

⁷⁰ South Africa also deviated from English law during the recent company law review process. Developments in the European Union were taken into account when English law was reviewed.

⁷¹ www.sadcreview.com (accessed 15 June 2006).

in South Africa and to facilitate harmonisation of business laws in SADC countries.⁷² The company law of Botswana is given specific consideration, in view of recent developments in that jurisdiction. The Botswana Companies Act of 2003⁷³ established a new corporate culture in Botswana and is discussed in this chapter with specific emphasis on the duties of directors.⁷⁴ This new 2003 Act is based on New Zealand company law. The relevant provisions of the New Zealand Companies Act⁷⁵ are therefore considered in order to interpret the Botswana Companies Act.

Chapter 6 considers the law in South Africa and various initiatives based on it. The various stakeholders are identified and the protection currently afforded them is indicated. The *King Reports*,⁷⁶ the *Policy Document* as well as the Companies Bill of 2007 are discussed, illustrating current opinion on the recognition of the different stakeholders and the codification of directors' duties.⁷⁷

In this chapter I attempt to clarify whether or not directors should manage the company by only taking the shareholders into account or whether they should consider a wider variety of interests. If specific groups are advanced, the issue arises as to which groups should be considered and what mechanisms should be adopted to enforce such a duty to all stakeholders. *Should* companies take the interest of all stakeholders into account or *may* they take the interests of all stakeholders into account? Clause 91(1)(b) of the Companies Bill of 2007 is discussed and evaluated. The Bill also provides for a partial codification of directors' duties. The advantages and disadvantages of a codification of directors' duties are illustrated. In this chapter

⁷² The *Policy Document* ch 3 par 3.5; Havenga "Regulating Directors' Duties" 609.

⁷³ Act 32 of 2004. This Act is referred to as the "Companies Act of 2003". It was enacted by Parliament on 10 December 2003. It only received Presidential Assent on 2 September 2004; therefore it is cited as Act 32 of 2004. This Act took a long time before it came into force, because there were no regulations until June 2007. The Act eventually came into operation on 3 July 2007.

⁷⁴ Kiggundu *Botswana Company Law*.

⁷⁵ Act 105 of 1993.

⁷⁶ *King Report on Corporate Governance for South Africa* 1994 (hereafter *King I*) and the *King Report on Corporate Governance for South Africa* 2002.

⁷⁷ Chapter 6 pars 4; 5 below.

the preferred view regarding the recognition of the different stakeholders in a South African context and its motivation are identified and discussed.

Chapter 7 contains a summary of the research undertaken. Some conclusions are drawn in respect of the position in South Africa, taking developments in the other jurisdictions considered into account. Finally, some recommendations are made.

5 REFERENCE TECHNIQUES

Company directors are referred to in the masculine form. Authorities are referred to in abbreviated form in the footnotes. The full references (with an indication of the abbreviated reference) are contained in the bibliography at the end of this thesis.

In the bibliography under the heading “Further Reading” other relevant sources are listed. These sources are valuable as they act as background to the topic of this thesis, but are not directly relevant when discussing the protection of stakeholders.

CHAPTER 2

THEORETICAL FOUNDATION

- 1 INTRODUCTION**
 - 2 SHAREHOLDER PRIMACY VERSUS STAKEHOLDER PROTECTION**
 - 3 THEORIES ON THE NATURE OF A COMPANY**
 - 4 MODELS OF CORPORATE GOVERNANCE**
 - 5 THEORIES RECENTLY APPLIED**
 - 6 CONCLUSIONS**
-

1 INTRODUCTION

As stated in chapter 1, the main aim of this thesis is to determine in whose interests a company should be managed. In order to address this question, it is necessary to have a sound theoretical foundation concerning shareholder primacy and the more current development of recognising the interests of different stakeholders, such as employees, creditors and consumers. This chapter therefore focuses on the various theories of corporate governance and the models that are based on them and which relate to the objectives of companies.

A number of competing explanations of corporate governance, specifically relating to the interests of different stakeholders, have developed over time.¹ The debate

¹ See Clarke *Theories of Corporate Governance*. This book provides a valuable explanation of corporate governance and its theoretical foundations by leading academics in the field such as Berle, Chandler, Jensen, Meckling, Clarke, Gordon and Coffee. In the introduction at pp 1–30 Clarke defines corporate governance, discusses theories of corporate governance (such as the agency and stakeholder theories) and provides post-Enron theories. See also the much older, but still relevant, work of Berle “The Impact of the Corporation” 25–40. He offers a review of the modern corporation Chandler “The Managerial Revolution” examines the managerial revolution. He explains how the shift towards managers running a corporation exerted great influence on determining the size and concentration of the United States’ industry. As the corporation grew in size and diversity, and its managers became more professional, the management of the corporation and its ownership became separated. See Clarke “The Stakeholder Corporation” 182–194 where he holds that managers are concerned with stakeholder interests, but at the same time they manage companies in order to maximise shareholder value. Managers find it difficult to satisfy the claims of shareholders and other stakeholders simultaneously; Gordon “What Enron Means for Management” 1233–1250; Coffee “What Caused Enron?” 269–309 (both these articles deal with Enron and its effect on the management of companies). Different theories of corporate governance are discussed in par 3 below.

between Berle and Dodd is considered first.² Their debate (especially Berle's viewpoints) centred on shareholder primacy, and the obligation of directors to recognise shareholder interests and the maximisation of their wealth. They (and more so Dodd) also addressed the interests of a wider variety of beneficiaries. The shareholder–stakeholder issue is, however, still an ongoing debate and the viewpoints of more recent commentators are also considered.³ The protection of stakeholders was also discussed during the South African and United Kingdom company law review processes; this is considered in paragraphs 2 and 5.

The different theories on the nature of a company, emphasising either a shareholder or stakeholder approach,⁴ are then discussed together with the various corporate governance models. The theories on the nature of a company are concerned with the origin and purpose of corporations, and shape the model that a company adopts.⁵ The first theory discussed, the agency theory, sees the company as a legal recognition afforded business people and deals with shareholder primacy.⁶ The concession and the *communitaire* theories focus on the role of the State as well as the recognition of stakeholders.

² As early as 1930, Professors Adolf Berle and Merrick Dodd debated this issue. See Dodd “For Whom are Corporate Managers Trustees?” 1145; Berle “For Whom Corporate Managers Are Trustees” 1365; Berle “Corporate Powers” 1049; Berle & Means *The Modern Corporation and Private Property*.

³ On the shareholder–stakeholder issue, see generally Coase “The Nature of the Firm” 386–405 (his work is of importance regarding the transaction cost economics. He holds that the minimisation of transaction costs are important, rather than the maximisation of profits); Jensen & Meckling “Theory of the Firm” 305–360 and Cheung “The Contractual Nature of the Firm” 1–21 who refer to and discuss the work of Coase. See also Hodes “The Social Responsibility of a Company” 468; Fisch “Measuring Efficiency” 646–648 (shareholder primacy defines the objective of the firm as profit maximisation. In this article it was argued that empirical research relied on by scholars is not sufficient to state that shareholder primacy should dominate regulatory policy); Fairfax “The Rhetoric of Corporate Law” 681–682 (this article deals with a growing embrace in stakeholder rhetoric, being at odds with current corporate practice) and Mallin *Corporate Governance* 10–12 who briefly discusses the different theories of corporate governance.

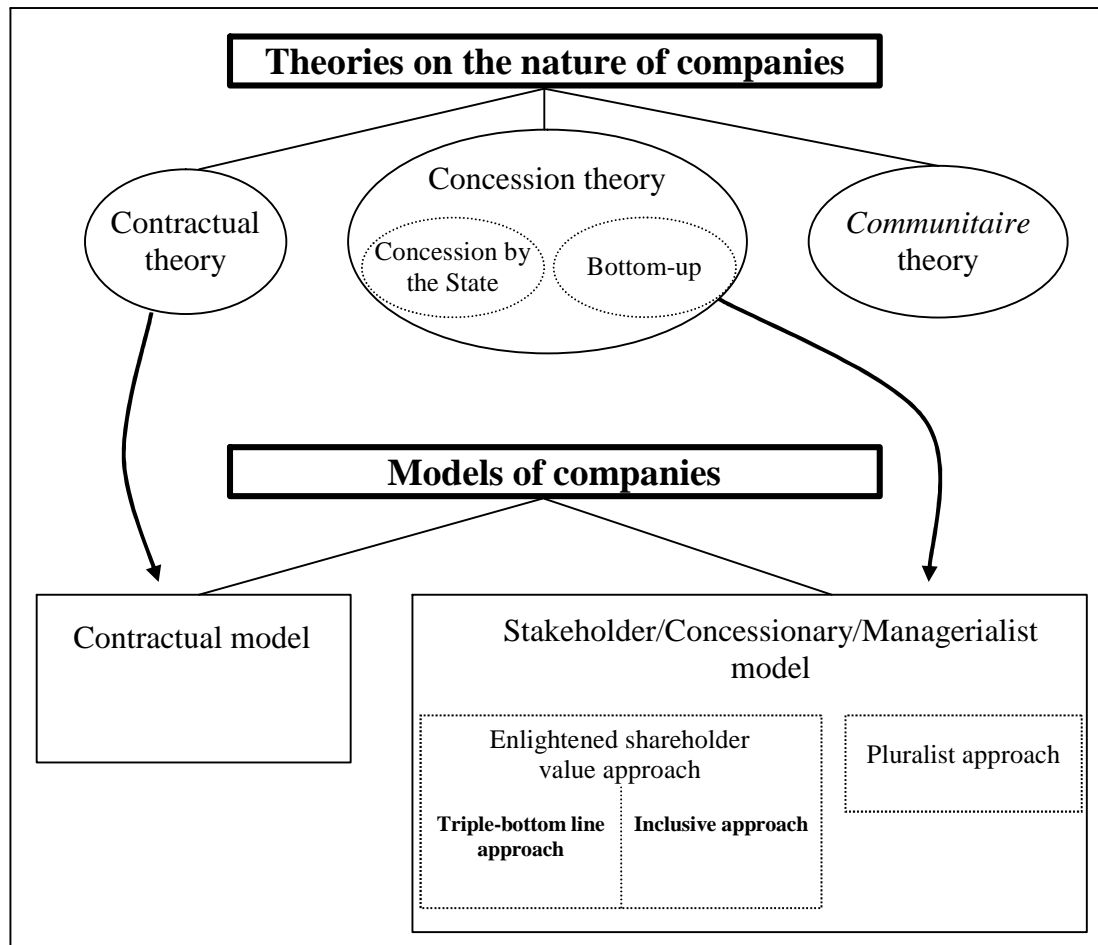
⁴ See, for example, Lombard *Directors’ Duties to Creditors* 21 who indicates that the *communitaire* theory is the basis for the stakeholder model.

⁵ Dine “Company Law Developments” 245.

⁶ Sheehy “The Reluctant Stakeholder” 200.

Lastly, the approaches applied during the South African and United Kingdom company law reform processes are discussed. A proposed combined theory on the recognition of stakeholder interests is recommended.

These theories and models are illustrated in the following diagram, which serves as a point of reference for the discussion below:



2 SHAREHOLDER PRIMACY VERSUS STAKEHOLDER PROTECTION

Two perspectives are relevant concerning the normative role of a corporation. The first concerns the shareholder primacy model⁷ and holds that it is a director's duty to

⁷ On shareholder primacy, see generally Sheehy "The Reluctant Stakeholder" 208 indicating that this does not mean that other parties (or stakeholders) should be ignored, but that shareholders should receive primacy when directors manage a company. He discusses the shareholder theory, indicating

maximise the profits of a company for the benefit of the shareholders. The second perspective concerns the stakeholder theory.⁸ In terms of this theory, directors should extend their obligations to a wider variety of stakeholders and not only to the company's shareholders.⁹

As early as 1930 Berle and Dodd debated the issue of shareholder primacy versus the protection of different stakeholders in America. Berle argued in favour of the shareholder primacy norm.¹⁰ He stated that directors hold the property of

that the main objective of the corporation is to maximise shareholder wealth. See also Anderson *Corporate Directors' Liability* 42 who states that the shareholder primacy theory recognises the special place of shareholders as residual owners of the company. Eisenberg "The Conception that the Corporation is a Nexus of Contracts" 825 refers to the "ownership" rights of shareholders due to their rights to possess, use and manage and the rights to income and capital. The issue of the separation of ownership and control is discussed in more detail below (see n 10 below).

⁸ The term 'stakeholder theory' was first used in 1963 at the Stanford Research Institute, although it can be traced back to work done by Dodd in the 1930s. See Clarke "The Stakeholder Corporation" 182–194; Sheehy "The Reluctant Stakeholder" 200. On the stakeholder theory, see generally Friedman *Capitalism and Freedom*; Freeman & Evan "Corporate Governance" 337–360 (defining organisations as multilateral agreements between the corporation and its stakeholders); Clarkson "A Stakeholder Framework" 92–117; Donaldson & Preston "The Stakeholder Theory" 65–91; Clarke & Glegg *Changing Paradigms*; Fairfax "The Rhetoric of Corporate Law" 681. In the book *Theories of Corporate Governance* edited by Clarke, various authors discuss the different theories, including the stakeholder theory (see pp 10–11 and part 6 on the stakeholder theory).

⁹ Penrose in *Theory of the Growth of the Firm* laid the intellectual foundations for the stakeholder theory in her concept of "the company as a bundle of human assets and relationships". See also Clarke "The Stakeholder Corporation" 182–194 and Fisch "Measuring Efficiency" 647. Blair *Ownership and Control* in the foreword states that corporations may be conceived as institutional arrangements for governing the relationships between all the parties that contribute company-specific assets, including, for example, employees who contribute specific skills (see Clarke *Theories of Corporate Governance* 171). See also Sheehy "The Reluctant Stakeholder" 201 where he discusses the stakeholder theory, stating that economics and efficiency are not ultimate values and that the distribution of costs and benefits for society's resources are also important.

¹⁰ Berle "For Whom Corporate Managers Are Trustees" 1372. He bases his argument (of trusteeship) on the fact that shareholders are owners of a company. Directors' obligations to shareholders are based on their role as trustees or agents to the shareholders (who are seen as the owners). He classifies a company in terms of the separation of ownership and control. He refers to the shareholders as owners and the directors as the people being in control. The classification of shareholders as owners has been criticised, see Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection" 13; Sheehy "The Reluctant Stakeholder" 226; Millon "Theories of the Corporation" 221. See also *King II* Introduction par 17.3. The critics argue that there are substantial differences between shareholders and traditional property owners. Shareholders own stock; which gives them claims to control and certain financial rights. They do not, however, have direct control over a company's underlying assets. Directors are also not directly controlled by their principals (as is the case with traditional agents). Directors' powers are largely statutory. The debate between Berle and Dodd provides insights into the historical foundations of the shareholder primacy norm. It does not, however, provide sufficient justification for defining a company in terms of shareholder primacy. The agency theory, based on the works of Coase, "The Nature of the Firm" 386; Alchain & Demsetz "Production, Information Costs" 777–795; Jensen & Meckling "The Theory of the Firm" 305–360; Fama & Jensen "Separation of Ownership and Control" 301–325 found it strange that the public

shareholders in trust for the sole benefit of the shareholders.¹¹ The exclusive obligation of directors was therefore the maximisation of shareholders' property. Dodd, in contrast, argued that directors serve as trustees for the entire community rather than for individual shareholders. Therefore, directors should use the company's resources to address the interests of a wider variety of stakeholders. By so doing, directors would behave in a socially responsible manner.¹² The crux of the debate concerned the issue of whether directors should serve only shareholders when they manage a company, or whether they should also act for the benefit of other interest groups.

In 1942 Dodd acknowledged that it was misleading to treat directors as trustees for employees, consumers and other interest groups.¹³ Berle also conceded that directors have the discretion of whether to consider the interests of other groups and manage a company in the general interests of society.¹⁴ They therefore distinguished between the obligations of directors towards shareholders and those towards stakeholders, but they acknowledged the legitimacy of the interests of other stakeholders.

The discussion of the shareholder-versus-stakeholder theories is still ongoing, and has been much debated by various international and local commentators since the debate

company with its separation of ownership and control has survived for so long (see Ramsay "Law and Economics" 48). See also, generally, Fisch "Measuring Efficiency" 650. The agency theory is discussed in more detail below in par 3.1. See also on the problem of the separation of ownership and control Yavasi "Corporate Governance Problems in the EU" 162.

¹¹ Berle "Corporate Powers" 1049.

¹² This theory of Dodd is referred to as the 'natural entity theory of the corporation'. It amounts to the following: directors are the agents of a corporate entity. Directors may therefore act in a manner that is to the shareholders' detriment if it is to the advantage of the company, as a separate legal entity. Management works for the company and their obligations to the shareholders are therefore only secondary. According to Dodd, businesses have "a social service as well as a profit-making function" (Dodd "For Whom are Corporate Managers Trustees?" 1147–1148). On the natural entity theory, see generally, Millon "Theories of the Corporation" 217–219. On the Berle–Dodd debate see also Hodes "The Social Responsibility of a Company" 485–487; Ramsay "Law and Economics" 48–49; Sheehy "The Reluctant Stakeholder" 195; Fairfax "The Rhetoric of Corporate Law" 681; Anderson *Corporate Directors' Liability* 40.

¹³ Dodd "Book Review" 547; Dodd "For Whom are Corporate Managers Trustees?" 1148; Fisch "Measuring Efficiency" 648.

¹⁴ Berle "For Whom Corporate Managers Are Trustees" 1356; Fisch "Measuring Efficiency" 648.

between Berle and Dodd.¹⁵ Jensen,¹⁶ for example, refers to the stakeholder theory, indicating that this theory implies that managers are accountable to all stakeholders. This will have the effect of managers not knowing to whom they are accountable, because there are no defined measurable objectives. Sternberg¹⁷ opposes the stakeholder theory. She argues that the stakeholder theory is incompatible with business and corporate governance, because it undermines private property, agency and wealth. Havenga states that “profit-sacrificing social responsibility”¹⁸ lies at the heart of the stakeholder theory. Instead of the company’s interests being identified with its shareholders’ financial interests, the company is seen as a separate legal entity where conflicting interests should be accommodated.¹⁹

The protection of stakeholders was also debated during the company law review process of South Africa. The drafting of a new Companies Act provided the ideal opportunity to resolve this issue, and to indicate which theory is preferred and how it should be applied practically. However, as is indicated later, the drafters of the Companies Bill of 2007 have, in my view, not addressed the matter sufficiently.²⁰

It is, however, clear that the recognition of stakeholders’ interests in the management of a company by directors is becoming more evident. Fairfax provides a number of

¹⁵ To name a few: Coase, “The Nature of the Firm” 386; Alchain & Demsetz “Production, Information Costs” 777–795; Jensen & Meckling “The Theory of the Firm” 305–360; Hodes “The Social Responsibility of a Company” 468; Fama & Jensen “Separation of Ownership and Control” 301–325; Wishart “Models and Theories” 323; Du Plessis “Direkteure se Pligte Teenoor Partye Anders as die Maatskappy” 378; Whincop *An Economic and Jurisprudential Genealogy*; Havenga “The Company, the Constitution and the Stakeholders” 134; Wheeler & Sillanpää *The Stakeholder Corporation*; Rosenfeld “A Pluralist Critique” 291; Dine “Company Law Developments” 245; Beuthin “The Range of a Company’s Interests” 155; Crowther & Rayman-Bacchus *Perspectives on Corporate Social Responsibility*; Mallin *Corporate Governance*; Farrar *Corporate Governance*; Clarke *Theories of Corporate Governance*.

¹⁶ Jensen “Value Maximization” 8–21.

¹⁷ Sternberg “Stakeholder Theory” 5–9.

¹⁸ Chapter 1 par 2.

¹⁹ Havenga “The Company, the Constitution and the Stakeholders” 137.

²⁰ See the discussion on the Draft Companies Bill of 2007 and the problems with its construction concerning in whose interests directors should manage a company in ch 6 par 4.3 below. The shareholder-stakeholder debate was also discussed during the United Kingdom’s company law review process, see ch 3 par 4.2.3. This discussion on shareholder versus stakeholder protection is also evident from the corporate governance initiatives in Australia, see ch 4 par 4.

examples where companies refer to the protection of different stakeholders.²¹ Firstly, company documents and websites increasingly refer to other groups and to the importance of social responsibility. Companies' annual reports justify the company's existence in terms of service to the community and not only in terms of profits made.²² Websites of most companies also have a link to "social responsibility" and include corporate activities, the granting of bursaries and charitable activities. Secondly, companies are increasingly adopting codes of good practice, and concentrate on other interest groups in these codes, which are sometimes required by the listing requirements of the exchange where they are listed.²³ Thirdly, companies have changed their infrastructure to accommodate other interest groups. Some companies employ people who are primarily responsible for the relations with interest groups other than the shareholders. Other companies have board committees to oversee the company's programmes relating to social responsibility and the interests of stakeholders.²⁴ Finally, some business schools have included "stakeholder protection" in their curriculum.²⁵

²¹ Fairfax "The Rhetoric of Corporate Law" 693–696.

²² Crook "The Good Company" 4.

²³ A *Code of Corporate Practices and Conduct* was also released in terms of the South African *King II Report*; see pp 21–45. Paragraphs 2.1.5, 3.1.4, 3.2.3, 8.3 in *King II* concern stakeholder interests. See also The Australian Stock Exchange (ASX) *Corporate Governance Council's Principles of Good Governance and Best Practice Recommendations* (March 2003 and August 2007). In terms of these principles a model code of good principles of corporate governance is suggested for companies (see p 59 of these principles and see the discussion in ch 4 par 4.1). See also the *Cadbury Report* and its *Code of Best Practice* in the United Kingdom (see ch 3 par 4.1). In addition to requiring listed companies to comply with *King II*, the JSE Limited (JSE) also launched a Socially Responsible Investment Index (SRI Index) in May 2004. In terms of this Index the JSE developed criteria to measure the "triple-bottom line" performance of the FTSE/JSE All Share Index. (See <http://www.jse.co.za/sri/index.htm> (accessed 20 January 2008).)

²⁴ Section 8, ch 8 of *King II* concerns board committees. *King II* suggests that companies should have committees dealing with governance, environmental, safety and health issues and audit, nomination, risk management and remuneration committees (at ch 8 par 6). It is stated in *King II* that committees of the board can help to efficiently advance its business. The board is still the focal point of the corporate governance system and is ultimately accountable and responsible for the affairs of the company. Board committees are therefore a mechanism to aid and assist the board and its directors by giving detailed attention to a specific area of the directors' duties and responsibilities (at ch 8 par 1).

²⁵ These are valid examples of companies' involvement in society, but one has to ask whether this is just lip service or "meaningless political exaggeration" (see Frost "Introduction to Classical Rhetoric" 613). Or is this precisely what is meant by the "triple-bottom line"? Companies should have regard to the interests of society, but shareholders still receive primacy. This issue is discussed later when determining which theory South Africa should follow, see par 5.2. See generally Fairfax "The Rhetoric of Corporate Law" 711–712.

Despite this growing interest in what Fairfax describes as “stakeholder rhetoric”, many commentators continue to believe that a company should be managed in terms of the shareholder primacy norm. The vast majority of commentators accept that the primary objective of directors should be to manage a company in such a way that the wealth of shareholders is maximised. Corporate conduct is therefore still measured in accordance with the view that shareholders should receive primacy when directors manage a company. The corporate governance model that a company adopts indicates in whose interests directors should manage a company. These models are based on various theories relating to the nature of a company. These theories are discussed below.

3 THEORIES ON THE NATURE OF A COMPANY

The two schools of thought or perspectives on the nature of a company were discussed in section 2 above. The first school advocates the advancement of shareholder primacy and the second the recognition of the interests of other stakeholders. These theories, emphasising either a shareholder or stakeholder element, are discussed below.

Three theories on the nature of a company are the focus in this section. They are the contractual (or contractarian/agency/*nexus-of-contracts*), concessionary and *communitaire* theories.²⁶ At the outset, it is important to highlight a number of issues.

²⁶ On these theories see generally: Ramsay “Corporate Theory” 179–188, who refers to the managerialist and contractual theories; Bottomley “Contractualism to Constitutionalism” 277–313 (specifically on the contractarian theory); Dine “Company Law Developments” 246; Bottomley “The Birds, the Beasts, and the Bat” 243–264 (on the concession theory); Cheffins *Company Law* 3–41 (on the contractarian theory); Keay “Directors’ Duties to Creditors” 672; Bolodeoku “Economic Theories” 411; Sheehy “The Reluctant Stakeholder” 193–240 refers to the contractarian, *communitaire* and concession theories; Clarke *Theories of Corporate Governance*; Velasco “The Rights of the Shareholder” 409–467 discusses the three main theories namely the contractarian theory (also referred to as the “law and economics theory”), the concession theory and the *communitaire* theory; Fisch “Measuring Efficiency” 656; Redmond “The Thrall of Shareholder Value” 79–83 who discusses the conflict between maximising shareholder value and the expectations of corporate responsibility, the demise of managerialism and the rise of shareholder value focus. He also provides alternatives to the dominance of shareholder value maximisation. See further Anderson *Corporate Directors’ Liability* (in ch 2 of her book she provides a good overview of policy and theoretical considerations especially relevant when considering in whose interests directors should manage a company. Her focus is on

Firstly, these theories are discussed by various commentators and not all of them describe them in the same manner. Substantial differences in the commentators' approaches are highlighted. An overview of the theories that are mostly accepted, as debated by various commentators, is provided. Secondly, these theories are discussed in order to provide the necessary historical and theoretical basis relating to the issue of stakeholder protection, but they will not necessarily provide a clear answer to the question of whom directors should serve when they manage a company.²⁷ Thirdly, the approaches recently applied in South Africa and the United Kingdom are discussed and evaluated. Fourthly, a proposed theory on the recognition of stakeholder interests is suggested.²⁸

3.1 The Contractual or Agency Theory

There are, broadly speaking, two strands of law and economic scholarship in the field of corporate law. The first is based on the agency theory or contractarian theory²⁹ and the second on the transaction-cost economics.³⁰ The former is concerned with addressing problems arising from the separation of ownership and control, whereas the latter is concerned with discovering internal measures and mechanisms to reduce costs linked to contractual hazards. In terms of the agency theory, the firm is seen as a

creditors as a specific group of stakeholders: at 13–63); Lombard *Directors' Duties to Creditors* 14–26 (also focusing on creditors).

²⁷ Or to put it differently, the theories and models will not necessarily bring one closer to the correct route to follow when determining in whose interests directors should manage a company.

²⁸ Paragraph 5.2.

²⁹ See n10 above where it is stated that the proponents of the agency theory (such as Alchain & Demsetz and Jensen & Meckling) tried to understand why the shareholder primacy theory survived so long, despite the agency problems based on the separation of ownership and control. See, more recently, Hart "Corporate Governance" 678–689 he refers to problems associated with the agency theory. These problems cannot always be resolved by way of a contract. Contracts are usually incomplete due to the high costs involved in negotiating on every possible aspect. Governance structures can be seen as a mechanism for making decisions that have not been specified in the original contract.

³⁰ Transaction cost economists are similar to contractarians as they also presume that individuals should live how they choose to live and make whatever arrangements they deem fit. They see companies as private initiatives and presume that all actors in the *nexus* of contracts are rational and desire to maximise their benefits. Law and economic scholars add to the viewpoints of the contractarians by emphasising financial economics and the need to reduce transaction costs (see Keay "Directors' Duties to Creditors" 674–675). Transaction cost economics are discussed in more detail below.

“*nexus of contracts*”³¹ whereas the transaction-cost economists view it as a governance structure.³² Although they have differences in emphasis, they also complement each other.³³

In terms of the contractarian or agency theory, the corporation is a web of contractual relationships.³⁴ Previously,³⁵ the corporation was seen as a single product entity with a commitment to the maximisation of profit, but the agency theory sees the corporation as a constantly renegotiated contract where each party wants to maximise his or her own utility. All relationships with the corporation are therefore contractual in nature; each of the various stakeholders contributes certain inputs in exchange for certain rights with respect to outputs. The details of the contribution and return depend on the specific contract. Shareholders are therefore not owners, but merely a type of investor.³⁶ Many contractarians regard the company as nothing more than a “number of complex, private contract-based relations, either expressed or implied, and they consist of many different kinds of relations that are worked out by those voluntarily associating in a company”.³⁷ These contractual relationships are voluntary in nature and corporate law is seen as an enabling set of statutes empowering stakeholders to enter into contractual relationships. Stakeholders should be able to structure their particular relationships as they deem fit. This theory is anti-regulatory

³¹ Velasco “The Rights of the Shareholder” 443; Mallin *Corporate Governance* 12; Anderson *Corporate Directors’ Liability* 31.

³² Mallin *Corporate Governance* 12.

³³ See Bottomley “Contractualism to Constitutionalism” 285. Some commentators discuss these two theories together, see Anderson *Corporate Directors’ Liability* 30–40; Velasco “The Rights of the Shareholder” 442–449.

³⁴ In terms of the contractual theory, two or more parties conclude a contract to carry on a commercial activity and it is from this contract that a company is born.

³⁵ See the above discussion on the work done by Berle, Means and Dodd. See further Ramsay “Law and Economics” 48; Clarke *Theories of Corporate Governance* 4, 57.

³⁶ See Velasco “The Rights of the Shareholder” 443, 447–448; Anderson *Corporate Directors’ Liability* 31 stating: “Shareholders are just one of these factors of production, and their contribution of equity capital is merely one type of input into which the company enters.” See also Millon “Theories of the Corporation” 229; Sheehy “The Reluctant Stakeholder” 230; Clarke *Theories of Corporate Governance* 5.

³⁷ Keay “Directors’ Duties to Creditors” 672.

and participants can opt out of rules should they wish to.³⁸ The theory also suggests that the shareholders are the principals and the directors or managers the agents. It offers shareholders a pre-eminent position in the corporation, but as stated above, not as a consequence of their being owners but rather due to their being residual risk takers.³⁹ Since the basis of the agency theory is the utilisation of self-interested value maximisation, the relationship between shareholders and directors will be problematic.⁴⁰ Because of this, the agent may not necessarily act in the best interest of the shareholder (or principal), or may do so only partially.⁴¹

The above-mentioned idea that a corporation is a series of contracts was developed in a different way by new institutional economists.⁴² Instead of focusing on the maximisation of profit, they focus on the minimisation of transaction costs.⁴³ Efficiency is therefore of the utmost importance to them. Efficiency concerns the

³⁸ Keay "Directors' Duties to Creditors" 672.

³⁹ In terms of the shareholder primacy theory, discussed above, shareholders receive primacy based on their being seen as "owners" of the firm. The agency theory emerged from work done by Alchian & Demsetz "Production, Information Costs" 777–795; Jensen & Meckling "Theory of the Firm" 305–360. See Clarke *Theories of Corporate Governance* for an illuminating discussion of the agency theory 4–7. See Velasco "The Rights of the Shareholder" 447–448, who refers to shareholders receiving primacy in terms of the agency theory, but not due to them being owners.

⁴⁰ The essence of the agency problem lies in the separation of ownership and control. This problem is referred to as "the agency cost problem". See Fama & Jensen "Separation of Ownership and Control" 304–305; Jensen "Self-interest" 40–55; Clarke *Theories of Corporate Governance* 4, 57; Anderson *Corporate Directors' Liability* 34; Mallin *Corporate Governance* 10–12, who explain the agency cost problem. See also Mitchell et al. "Shareholder Value and Employee Interests" 424 for a discussion of the shareholder and stakeholder theories. The problem of the stakeholder theory is, in short, the lack of stakeholder involvement in corporate decision making. The division between ownership and control is problematic when applying the shareholder theory.

⁴¹ The agent may, for example, not take appropriate risks. The agent will also usually have more information than the principal, placing the principal at a disadvantage. See Mallin *Corporate Governance* 10–11.

⁴² See generally a working paper of Learmount "Theorising Corporate Governance". The transaction costs theory is based on the work done by, *inter alia*, Coase "The Nature of the Firm" 386–405; Williamson "Transaction-Cost Economics" 233–261; Hart "Corporate Governance" 678–689. Coase examines the existence of the firm in the context of a framework of the efficiencies of internal as opposed to external contracting. He says (at 392) that "[t]he operation of a market costs something and by forming an organisation and allowing some authority (an "entrepreneur") to direct the resources, certain marketing costs are saved. The entrepreneur has to carry out his function at less cost, taking into account the fact that he may get factors of production at a lower price than the market transactions which he supersedes." Williamson "Corporate Governance" 1197–1230 builds on the work done by Coase. These viewpoints are also explained in Mallin *Corporate Governance* 13.

⁴³ See Clarke *Theories of Corporate Governance* 6.

relationship between the aggregate benefit of a legal rule and the aggregate costs of such a rule. These scholars argue that any expansion of the responsibilities of directors would produce inefficiencies in corporate governance.⁴⁴ To impose additional duties on directors would hamper transaction costs and prevent resources from being used in the most productive and efficient way. Keay states that “the concern is that any greater imposition on directors will make them less efficient in their role as agents of the shareholders of the company, because amongst other things, they will start to think of their own positions, rather than maximising profits”.⁴⁵

3.2 The Concession Theory

Commentators’ discussions vary in their approaches. Some commentators discuss this theory together with the *communitaire* theory.⁴⁶

According to Sheehy, the concession theory holds that a corporation’s existence and operation is a concession granted by the State to use this corporate tool.⁴⁷ The company is therefore seen as a creation of the State.⁴⁸ This theory does not indicate precisely who the beneficiaries of directors’ fiduciary duties should be. It is, however, acknowledged that the beneficiaries include a wider variety of interests than the contractarian theory, which focuses on shareholders as the main beneficiaries. Parkinson states that the concession theory regards the company as owing its

⁴⁴ Coase “The Nature of the Firm” 386–405; Anderson *Corporate Directors’ Liability* 35.

⁴⁵ Keay “Directors’ Duties to Creditors” 676. In this article Keay provides some reasons why the contractarian theory, as applied by the law and economics school, is opposed to a duty to consider the interests of creditors. He focuses on efficiency and the undermining thereof if creditors are considered. He argues further that efficiency is not the only factor that can determine whether directors should have a duty to consider the interests of creditors. Fairness should also be considered. A duty to creditors can actually enhance efficiency in certain cases. This is discussed in more detail in ch 6 par 3.2 below.

⁴⁶ Anderson *Corporate Directors’ Liability* 30–40; Velasco “The Rights of the Shareholder” 442–449.

⁴⁷ With the development of the discipline of economics, the contractarian theory became more prominent as opposed to the concession and *communitaire* theories; see Sheehy “The Reluctant Stakeholder” 232.

⁴⁸ On the concession theory, see generally Berns & Baron *Company Law and Governance* 20 (the corporation was originally seen as a public, rather than private institution); Dine “Company Law Developments” 247; Bottomley “The Birds, the Beasts, and the Bat” 243–264; Mahoney “Contract or Concession” 873–894; Kostant “Team Production” 674–676; Sheehy “The Importance of Corporate Models” 463–514; Sheehy “The Reluctant Stakeholder” 230–234; Velasco “The Rights of the Shareholder” 459–462; Lombard *Directors’ Duties to Creditors* 18.

existence to an exercise of State power. The company is therefore a creature of the State that should promote public welfare. The State has the right to interfere in the internal affairs of the company and need not confine itself to external or general law regulation.⁴⁹

According to Dine, the concession theory has two branches.⁵⁰ The first branch is similar to the discussion above, referred to as “a concession by the State theory”. The second branch, referred to as the “bottom-up concessionary theory”, sees the company as an extension of the contracting parties’ original agreement. By forming a company, the parties have created an instrument with a real identity separate from the original contracting parties.⁵¹ According to the second branch, directors should consider a wider variety of interests when managing a company, but there is no indication of how the different interests of various stakeholder groups should be balanced.⁵²

3.3 The Communitaire Theory

The third theory is the *communitaire* theory.⁵³ It regards the company as an instrument (and not a mere concession) of the State. According to this theory, the aims of the company reflect the aims of society. The company does not have a strong commercial character, but has become the tool used by the State to give effect to its goals. The risk inherent in this theory lies in the fact that the commercial goal of a company might be lost.⁵⁴

⁴⁹ Parkinson *Corporate Power* 25–33.

⁵⁰ Dine “Company Law Developments” 247.

⁵¹ Lombard *Directors’ Duties to Creditors* 21.

⁵² This problem is highlighted when the different stakeholder groups are discussed in the South African chapter (see ch 6 par 3).

⁵³ Academics who responded to the work done by the law and economics scholars (who rely on profit maximisation) are usually termed ‘*communitarian* scholars’ see Kostant “Team Production” 668.

⁵⁴ On the *communitaire* theory, see generally Bottomley “Contractualism to Constitutionalism” 277–313; Sheehy “The Reluctant Stakeholder” 193–240, who discusses the *communitaire* and concession theories under the same heading; Anderson *Corporate Directors’ Liability* 44–46; Lombard *Directors’ Duties to Creditors* 18. In Andriof & McIntosh *Perspectives on Corporate Citizenship*, Wood & Logsdon discuss the *communitarian* revolution, stating that according to this revolution businesses

The *communitaire* theory looks at the place of the company in the community. According to this theory, stakeholders are vulnerable to abuse and should be protected. Their goal is the long-term viability of the corporation and they rely on the co-operation of all corporate stakeholders to achieve this. Ethical behaviour and fairness are therefore also required. The company will consider the interests of the stakeholders if it will benefit from doing so in the long-term.⁵⁵ It is, however, unclear how the *communitaire* theory intends to achieve this goal.⁵⁶

In terms of this theory, companies should have political, social and economic dimensions. Justice and co-operation are important values in terms of this theory. The contractual theory is not rejected by proponents of the *communitaire* theory, but they emphasise responsibility, instead of freedom (of contract). They argue that corporate law should confront the harmful effects of shareholder maximisation on stakeholders. They therefore do not accept profit maximisation for shareholders as the main objective.⁵⁷

At present the State does not play the role of concessionary, as described by the concession and *communitaire* theories. The South African Companies Bill of 2007 provides individuals with the right to incorporate a company.⁵⁸ These theories are, however, still important because of their emphasis on the role of stakeholders instead

have a social role to play in communities, regardless of the costs involved. Businesses are more than shells with which individual contracts are negotiated.

⁵⁵ Kostant “Team Production” 674–676; Anderson *Corporate Directors’ Liability* 45.

⁵⁶ Williams “Corporate Social Responsibility” 711–717 focuses on the importance of disclosure for improved corporate social responsibility; Greenfield “Using Behavioral Economics” 642 emphasises the importance of procedural fairness. According to Williams and Greenfield, corporations are public as well as private entities and have an obligation to serve socially responsible goals.

⁵⁷ Velasco “The Rights of the Shareholder” 455–459. He focuses on the stakeholder element of the *communitaire* theory and not on the fact that a company is seen as an instrument of the State.

⁵⁸ See clause 13 of the Companies Bill 2007. It is a core principle of company law that the formation of a company is an action by persons exercising their constitutional right of freedom of association and their common law right of freedom to contract (see the *Explanatory Memorandum* of the Companies Bill of 2007 at p 10). Part IV of the current South African Companies Act of 1973 deals with the formation of companies. In s 32 the mode of forming a company is explained. There is no specific provision stating that a person has a right to incorporate a company.

of profit maximisation for shareholders. In the next section the models that are based on these theories are discussed.

4 MODELS OF CORPORATE GOVERNANCE

As indicated above, the models that companies apply relating to corporate governance, and specifically stakeholder protection, are based on the aforementioned theories. The first model discussed below highlights shareholder primacy and the second model the protection of the interests of stakeholders.

The contractual model is based on the contractarian or agency theory. As described above, the company is seen as a *nexus* of contracts. Although the scholars of this theory do not see the shareholders as the owners of the firm, they still award them with primacy.⁵⁹ The wishes of the shareholders are seen as the overriding factor when directors manage a company. Directors should therefore manage a company “in the best interests of the company”, being the shareholders collectively. Other interest groups, such as employees and creditors are excluded, and not seen as direct beneficiaries of directors’ fiduciary duties.⁶⁰ The goal of this model is to maximise shareholder wealth, and by so doing also benefiting society.⁶¹

The second model is the concession model. It is also referred to as the stakeholder or managerialist model.⁶² This model is based on the concessionary theory and especially the “bottom-up” concessionary theory, discussed above. There are two variants of this “bottom-up” model, according to Dine: “The first variant of the model

⁵⁹ See n10 above. See also Berns & Baron *Company Law and Governance* 18 who say that the contractual model is aligned with the traditional economic model where the rights and responsibilities within a corporation are considered to be a matter of private concern.

⁶⁰ Dine “Company Law Developments” 248.

⁶¹ On the contractual model, see Botha “Confusion in the King Report” 33 who discusses the different models of corporate governance in a South African context. He evaluates *King I* in view of these models and states that the essence of this model is to maximise shareholder wealth. See also Berns & Baron *Company Law and Governance* 18; Sheehy “The Reluctant Stakeholder” 228.

⁶² Botha “Confusion in the King Report” 26.

sees the company as run in the interests of shareholders, it being in the interests of shareholders to take account of other interest groups, because to ignore them would damage shareholder interests”. She further states that “[i]n the second variant of the model it is accepted that interests of other groups must be taken into account because such an approach directly benefits the company. The ‘interests of the company’ are seen as including at least the interests of employees and creditors as well as shareholders.”⁶³ I submit that the first variant is in line with the enlightened shareholder value approach and the second with the pluralist approach.⁶⁴ These approaches are discussed in paragraph 5.1.

5 THEORIES RECENTLY APPLIED

5.1 The Enlightened Shareholder Value and Pluralist Approaches

During the South African and United Kingdom company law reform programmes the drafters referred to two specific theories relating to the management of a company by directors, namely the enlightened shareholder value and pluralist approaches or theories.⁶⁵ It is therefore important to understand where these approaches fit in when discussing theories on the nature of a company and the models based on these theories.

As stated above, these approaches are linked to the concession theory as explained by Dine’s version of the “bottom-up” concession theory.⁶⁶ Similar to the concession

⁶³ Dine “Company Law Developments” 249 (emphasis added).

⁶⁴ See also, generally, on the enlightened shareholder value and pluralist approaches: Sealy “Directors’ Wider Responsibilities” 173; Havenga “The Company, the Constitution and the Stakeholders” 136–137; Proctor & Miles “Duty, Accountability and the Company Law Review” 21–26; Dean “Stakeholding and Company Law” 66; Miles “Company Stakeholders” 56. These terms were also used during the South African and United Kingdom company law reform processes. See the *Policy Document* ch 3.

⁶⁵ See ch 3 par 4.2.3 for these approaches applied during the company law reform in the United Kingdom and ch 6 par 4 for the South African position.

⁶⁶ Paragraph 3.2.

theory these approaches have a stakeholder element⁶⁷ (the pluralist approach more so than the enlightened shareholder value approach) and do not solely advocate shareholder primacy as did Berle in the 1930s.⁶⁸

The enlightened shareholder value approach provides for the maximum protection of shareholders. Other stakeholders are also considered, but their interests are subordinate to those of the shareholders. Ultimately, profit maximisation is the main goal of the directors.⁶⁹

The second school is that of pluralism. In terms of this approach, directors owe fiduciary duties to different stakeholders. The interests of employees may in certain instances receive priority over those of the shareholders collectively.⁷⁰ Both the United Kingdom and South Africa opted for the enlightened shareholder value approach during their company law review processes. This indicates that shareholders are still the primary beneficiary of directors' duties. The advantages and disadvantages of shareholder primacy are discussed below to determine whether there are valid foundations for directors to treat shareholders as the primary beneficiary of their fiduciary duties.

In chapter 3⁷¹ these approaches are discussed as referred to during the United Kingdom company law review and in chapter 6 as referred to in the South African *King Reports*, the *Policy Document* and the Companies Bill of 2007.⁷²

⁶⁷ These approaches do not have the element of a company being a concession by the State.

⁶⁸ Paragraph 2.

⁶⁹ See n7 for authorities on shareholder primacy. See also generally: Sheikh "Introduction to the Corporate Governance Themed Issues" 267, 268; Cheffins "Teaching Corporate Governance" 515–525 and the *Policy Document* ch 3 par 3.2.2.

⁷⁰ See n8 for academic articles dealing with the stakeholder theory. See generally Sealy "Directors' Wider Responsibilities" 173; Havenga "The Company, the Constitution and the Stakeholders" 136–137; Proctor & Miles "Duty, Accountability and the Company Law Review" 21–26; Dean "Stakeholding and Company Law" 66; Miles "Company Stakeholders" 56 and the *Policy Document* ch 3 par 3.2.2.

⁷¹ Chapter 3 par 4.

⁷² Chapter 6 par 4.

5.1.1 Arguments for and Against Shareholder Primacy

The enlightened shareholder value and pluralist approaches, discussed above, moved away from the traditional approach where shareholders received exclusive protection when directors managed a company. Therefore, in the next section arguments that support exclusive shareholder protection are evaluated.⁷³

According to the first argument, the shareholders own the company and its assets and, accordingly, have a legitimate claim to have the company managed in their own best interest.⁷⁴ There is, however, a flaw in this argument: from the date of incorporation the company is a separate legal person with a separate legal personality and thus it cannot be owned.⁷⁵ Roach argues that despite this, shareholders are still seen as the owners of the company, making this argument extremely resistant to change. A possible reason is the narrow definition given to “assets”. This ownership argument seems to be based on the premise that assets only relate to capital assets. However, assets include anything useful or valuable and the *financial* definition of an asset is therefore too narrow. For example, employees contribute labour to the company. It may be argued that as the company benefits from this asset, those who contribute to it should also benefit by being taken into consideration by directors when they manage the company.⁷⁶ It is justifiable to base arguments for shareholder primacy on ownership, but stating that shareholders (or any stakeholder that contributes to the company) own the company is misleading. It should rather be stated that since the company owns, and benefits from, the assets, those who contribute to these assets should also benefit.

⁷³ These relate to arguments generally provided for and against exclusive shareholder protection. Arguments relating to each specific interest group are discussed in detail in ch 6.

⁷⁴ As advanced by Roach “The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection” 13. See also Esser “The Enlightened-Shareholder-Value Approach” 721. See also n 10 for incisive authorities dealing with the issue of separation of ownership and control.

⁷⁵ *Aron Salomon v Salomon & Co Ltd* [1897] AC 22 (HL) (a company is legally separate from its members). As stated by Lord Macnaghten: “The company is at law a different person altogether from the subscribers to the memorandum” (at 51). See also Cilliers & Benade *Corporate Law* 10, where the consequences of separate legal personality are listed. They include that the assets of the company are the exclusive property of the company and that members may only share in a division of the assets at liquidation: *S v de Jager* 1965 (2) SA 616 (A) at 625. See further Sher “Piercing the Corporate Veil” 51; Dine “Company Law Developments” 246.

⁷⁶ Roach “The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection” 13.

The second argument in favour of shareholder primacy concerns the aspect of risk. It is argued that as the shareholders bear the risk of poor corporate performance, they should hold the right to the company's residual income. The counter-argument is that shareholders can substantially reduce their overall risk by way of a policy of diversification. If the risk they face can be minimised, then the claim for exclusive protection weakens too.⁷⁷ Apart from private companies where the articles of association or shareholder agreements can occasionally prevent shareholders from selling their shares immediately by, for example, requiring that they should first offer the shares to the current members. Shareholders in public companies can predict risk and avoid sustaining losses by simply selling their shares. Over time there is virtually no financial risk at all for the original providers of share capital. An increase in the share price would soon reduce the risk for a shareholder to zero. If shares were originally issued at R1 per share and the shareholder holds 1 000 000 shares, he could sell 500 000 of the shares when the price reaches R2 per share to recoup his original investment. This may sometimes take some time, but the shareholders are not totally excluded from returns on their original investments since they would normally receive dividends when profits are made. Shareholder risks are also reduced considerably by way of large professional investment funds and the rapid rise of institutional shareholders over the last three decades.⁷⁸ The company's constitution forms a contract between the company and its shareholders and the shareholders among themselves.⁷⁹ This is indeed a special contract that can only be amended by special resolution, but the shareholders have exclusive powers to amend it and this provides for considerable contractual protection. There is also ample scope for contractual protection of shareholders by way of shareholder agreements. Although it is generally true that shareholders do not have protection under separate laws, there

⁷⁷ Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection" 13.

⁷⁸ See, generally, on the role of institutional shareholders in good governance Ramsay et al. "Corporate Governance: The Perspective of Australian Institutional Shareholders" 110; Stapledon *Institutional Shareholders and Corporate Governance*; Rademeyer & Holtzhausen "King II, Corporate Governance and Shareholder Activism" 767.

⁷⁹ See Du Plessis "Prominensie van die Statute" 94; 96 n18 where he discusses the articles of association and the memorandum of incorporation of a company.

are formidable protections imbedded in most modern economies to protect shareholders. Shareholders are protected under company law in terms of statutory derivative actions, continuous disclosure provisions, actions aimed at oppressive and unfairly prejudicial conduct, insolvent trading provisions, reckless trading provisions and insider trading provisions.⁸⁰

The third argument is that shareholders should enjoy exclusive protection because they cannot protect themselves contractually. They may rely on the articles of association,⁸¹ but management lays down the conditions unilaterally in the original articles of association.⁸² Other stakeholders, such as employees and creditors, can protect themselves contractually, but this option is not open to the shareholders.⁸³

The last argument, and probably the most valid of the three, is that most of the other stakeholders have separate legislation protecting their interests.⁸⁴ Shareholders do not have separate legislation protecting their interests.

5.2 A Proposed Combined Theory Relating to the Recognition of Stakeholder Interests

Owing to the flaws in shareholder protection mentioned above and based on the fact that none of the theories discussed above provides directors with clear guidelines

⁸⁰ Esser & Du Plessis “Stakeholder Protection” 358.

⁸¹ The articles of association determine how the company shall function. Among other things, the rights, duties and powers of directors are set out in the articles of association. The articles of association constitute a contract between the company and its members and between the members amongst themselves. See s 65 of the Companies Act; Cilliers & Benade *Corporate Law* 79–81. See also *Hickman v Kent or Romney Marsh Sheep Breeders’ Association* [1915] 1 Ch 881 (it was held that a member is contractually bound by a provision in the articles stating that disputes between the member and the company should be submitted for arbitration); *De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873 (O) (the articles constitute a contract between the company and its members, in their capacity as members).

⁸² The articles can be amended at the general meeting (see s 62 of the Companies Act).

⁸³ Roach “The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection” 9–15. See in general Esser “The Enlightened-Shareholder-Value Approach” 721.

⁸⁴ See, for example, the Labour Relations Act 66 of 1995 protecting the interests of employees. See ch 6 par 3.3 for a discussion on the position of employees in South Africa. See also Esser “The Protection of Employees” 407–426.

concerning the beneficiaries of their duties when managing a company, a proposed combined theory on the protection of stakeholders is recommended in this section. It is argued below that this proposed theory is based on a “merry-go-round approach”.⁸⁵

The starting point of a sound model of corporate governance should be the fundamental principle that directors owe their fiduciary duties to the company and to the company alone, since the company is a separate legal entity from the moment it is registered until it is deregistered.⁸⁶

The company represents several interests. These include those of shareholders, employees, consumers, the community and the environment. Thus, requiring of directors to act in good faith in the interest of “the company” cannot mean anything other than a blend of all these interests, but first and foremost acting in the best interests of the company as a separate legal entity. The various interests therefore have different weightings. It will also be appropriate for a court to consider any other remedies under other legislation before it allows a particular interest to rely on specific company law remedies. Such an approach by the courts may well reveal that a particular interest is already well catered for under separate legislation. In view of this, the protection afforded other stakeholders in South Africa, the United Kingdom and Australia is discussed in chapters 3, 4 and 6.

It is proposed that an interest that may be primary at one particular moment in the company’s existence, may become secondary at a later stage. This is an ongoing process that could be compared to a merry-go-round (the company): many interests are represented in this merry-go-round at any particular time. Just like a merry-go-round there are sometimes short stops to let some participants get off and to take other participants on board. But then the motion continues with the participants

⁸⁵ See on this proposed approach Esser & Du Plessis “Stakeholder Protection” 358.

⁸⁶ The importance of a company’s separate legal personality is evident from clause 12 of the South African Companies Bill of 2007 which states that a company is a legal person:

- (1) From the date and time that the incorporation of a company is registered, as stated in its Registration Certificate, the company –
 - (a) is a juristic person, which exists continuously until it’s [*sic*] name is removed from the Companies Register in accordance with this Act; and
 - (b) has all of the legal powers and capacity of an individual, except to the extent that a juristic person is incapable of exercising any such powers, or having any such capacity.

(interests) constantly moving up and down without any real finishing line and the rotating speed may even vary, until it comes to a permanent standstill when the company is liquidated. Even then it will require of the court to weigh up the various interests of at least creditors, shareholders and employees. During the existence of the company, the directors are required to focus on the interests of “the company” (merry-go-round) as well as the various other interests, moving up and down just like those who are enjoying the ride on the merry-go-round.

It should be remembered that the meaning of “the company” only becomes obscure if the term is, for historic reasons,⁸⁷ equated with the shareholders collectively. Thus, the only solution is indeed for the legislature to step in and change this traditional interpretation where “the company” is interpreted as meaning the shareholders collectively.

It is argued that it is unnecessary to give any particular tag to this view of the company, other than stating that it is based on a simple juridical reality (“teorie van eenvoudige juridiese realiteit”) as Naudé already pointed out in 1970.⁸⁸ The natural entity theory postulates that directors are the agents of a corporate entity. Directors could therefore act in a manner that is to the shareholders’ detriment if it is to the advantage of the company, as a separate legal entity.

To summarise, the proposed theory states that a company is represented by various interests and the degree of importance attached to these interests varies during the existence of a company. Directors should be aware of this and should specifically bear legislation, other than company legislation, protecting these stakeholders in mind when managing a company.

⁸⁷ See Naudé *Die Regsposisie van die Maatskappydirekteur* 13, relying on Sealy “The Director as Trustee” 90.

⁸⁸ Naudé *Die Regsposisie van die Maatskappydirekteur* 18–19.

6 CONCLUSIONS

In this chapter a theoretical foundation was provided for the theories on the nature of a company and various corporate governance models. The agency, concession and the *communautaire* theories were discussed.⁸⁹ In terms of the agency theory, the corporation is described as a “*nexus* of contracts”. The various stakeholders contribute certain inputs in exchange for certain rights with respect to outputs. In terms of this theory, the shareholders are the principles and the directors the agents. Shareholders have a pre-eminent position in the corporation since they are the ultimate risk takers. The separation of ownership and control is a problem when applying this theory.⁹⁰ The concession theory states that a corporation’s existence is a concession of the State in granting the ability to use this corporate tool. Shareholders are not the only beneficiaries of directors’ duties in terms of this theory, other stakeholders are also important.⁹¹ A company is regarded as an instrument of the State in terms of the *communautaire* theory. Stakeholders should be protected according to this theory. The long-term viability of the corporation is important.⁹²

Approaches on stakeholder protection that have recently been applied in South Africa and the United Kingdom were also considered. The first approach, namely the enlightened shareholder value approach, focuses on shareholder primacy and the second, the pluralist approach, on the protection of stakeholder interests.⁹³

It was found that the corporate governance theories and models have either a shareholder or a stakeholder emphasis.⁹⁴ It is, however, important to note that these theories are not the only relevant approaches regarding corporate governance models and specifically not as far as the protection of stakeholders are concerned. To analyse

⁸⁹ Paragraphs 3.1–3.3.

⁹⁰ Paragraph 3.1 above.

⁹¹ Paragraph 3.2 above.

⁹² Paragraph 3.3 above.

⁹³ Paragraph 5.1 above.

⁹⁴ Paragraphs 3, 4 above.

the different theories of, and approaches to, company law is a complex task and commentators hold widely divergent views relating to these theories and approaches.⁹⁵

Arguments for and against shareholder primacy were considered. A number of shortcomings were identified.⁹⁶ In view of these shortcomings, a proposed combined theory was recommended on the recognition of stakeholder interests.⁹⁷ In terms of this theory, it cannot be denied that a company is a separate legal entity, representing several interests, including those of shareholders, employees, investors, consumers, the community and the environment. Directors should therefore consider the interests of various stakeholders when acting in “the best interests of the company”. These interests and the weighting attached to them may differ during the various stages of a company’s existence. The protection that these stakeholders receive in other legislation may also play a role when a court decides on the competing interests of different stakeholders.⁹⁸ Because legislation, other than company law legislation, plays such an important role, the protection that stakeholders in the United Kingdom, Australia and South Africa receive in other legislation is discussed in the rest of this thesis.

⁹⁵ Paragraph 3 above.

⁹⁶ Paragraph 5.1.1 above.

⁹⁷ Paragraph 5.2 above.

⁹⁸ Paragraph 5.2 above.

CHAPTER 3

THE LAW IN THE UNITED KINGDOM

- 1 INTRODUCTION**
 - 2 HISTORICAL OVERVIEW**
 - 3 THE POSITION RELATING TO DIRECTORS' DUTIES PRIOR TO THE COMPANIES ACT OF 2006: AN OVERVIEW**
 - 4 THE STAKEHOLDER DEBATE: CORPORATE GOVERNANCE CODES, THE COMPANY LAW REVIEW PROCESS AND THE COMPANIES ACT OF 2006**
 - 5 CONCLUSIONS**
-

1 INTRODUCTION

In this chapter the company law of the United Kingdom is discussed. First, a general overview of English company law, and specifically the law relating to directors' duties, is provided. Traditionally, directors' duties fall into two categories in English common law, namely, the fiduciary duty of good faith and the duty of care and skill. These directors' duties are confirmed in case law, legislation and also in the articles of association of individual companies.¹

Various corporate governance codes and the recent company law reform process, which led to the enactment of the Companies Act of 2006, are then considered. The Companies Act of 2006 is applicable in England, Scotland, Wales and Northern Ireland.² When discussing the codes, the consultation documents of the Steering

¹ See generally Birds "The Reform of Directors' Duties" 149; Keay "Section 172(1)" 106 (specifically on the stakeholder debate and the Companies Act of 2006).

² See the definition of "company" in s 1(1) of the Companies Act of 2006, in terms of which the "Companies Act" extends to the whole of the United Kingdom. See also the *Explanatory Notes on the Act* available at <http://www.dti.gov.uk/bbf/co-act-2006/> (accessed 10 February 2008). Scotland and the Welsh Assembly do not have legislative powers in the area of company law, although Scotland has the power to legislate on certain matters such as the regulation of business names. The Scottish Parliament agreed to a legislative consent motion on 16 March 2006. Northern Ireland has legislative powers on company law. Previously, they enacted company law legislation mirroring those of Great Britain (see the Companies (Northern Ireland) Order 1986) in terms of the 1985 Companies Act. In relation to the

Group drafted during the company law review process and the Act, the emphasis is on directors' duties and specifically on the issue of in whose interests they should manage a company. Section 172(1) of the Act, which deals with the protection of stakeholders, is therefore discussed specifically. The exhaustive code provided for in the Companies Act of 2006 is also considered.³ This code is exhaustive in the sense that courts cannot develop new principles, but existing principles may be developed with reference to existing case law.⁴

2 HISTORICAL OVERVIEW

The history of English company law can be divided into the following stages: from earliest times⁵ until the South Sea Bubble Act, from the Bubble Act until the first Companies Act in 1844, from 1844 until the United Kingdom's accession to the Common Market and from 1972 until the present.⁶

new Companies Act an agreement was reached with Northern Ireland stating that they still have the power to enact separate legislation (see s1284 of the Companies Act of 2006). See also Palmer *Annotated Guide* 56, 933 on this issue.

³ The Steering Group referred to a "statement" on directors' duties, but some commentators refer to it as a "code". For purposes of this thesis the same meaning should be attached to "statement" and "code". I submit that it is better to refer to a "statement of directors' duties" if the common law is still applicable, as is the case with the draft Companies Bill of 2007 in South Africa. If the common law is no longer applicable, I suggest that it is preferable to refer to a "code of directors' duties". See also ch 6 par 5.

⁴ See ss 171–177 of the Companies Act of 2006. See also *Modern Company Law Review for a Competitive Economy: Developing the Framework*, URN 00/656 (March 2000) available at <http://www.dti.gov.uk/cld/modcolaw.htm> (hereafter *Developing the Framework*) at pars 3.20, 3.82; *Modern Company Law Review for a Competitive Economy: Completing the Structure*, URN 00/1335 (2000) available at <http://www.dti.gov.uk/cld/modcolaw.htm> (hereafter *Completing the Structure*) at pars 3.2, 3.6, 3.12; *Modernising Company Law: The White Paper* (March 2005) available at <http://www.dti.gov.uk/companiesbill/whitepaper.htm>. (hereafter the *2005 White Paper*) at par 3.3 stating that the code is exhaustive in nature and that it will replace the common law. Whether or not the code is really exhaustive is evaluated in par 4.3.4 below.

⁵ As early as the fourteenth century.

⁶ See Farrar & Hannigan *Company Law* 15–24 on the general history of English company law and the different stages in the development of English company law. See also Davies *Gower and Davies' Principles of Modern Company Law* 19–54; Birds et al. *Boyle & Birds' Company Law* 1–12.

2.1 From Earliest Times Until the South Sea Bubble Act

In the Middle Ages, the principal trades were regulated by the guilds of the merchants.⁷ The guilds regulated a broad branch of trade or conferred on their members a monopoly of dealing in a particular kind of commodity.⁸ Groups of merchants conducted business overseas. Each member conducted trade with its own “stock” and for its own account, but subject to the rules of the guilds by way of partnerships.⁹ Trading therefore took place through joint associations as opposed to individual trading. The purpose of the guild was to ensure an adequate level of profit to the poorest business. The guilds were part of the structure of municipal organisation in England. They existed for social as well as economic purposes.

The *commenda* and the *societas* were two of the earliest business forms and bear some resemblance to the modern partnership. The *societas* was a more permanent association and similar to the modern partnership. The *commenda* was a cross between a modern partnership and a loan. One person would advance money to a trader on terms that should have a return which varied with the profits.¹⁰ At common law the only means of incorporation was by way of Royal Charter.¹¹ The purpose of incorporation was to confer protection and status. Incorporation by way of Royal Charter was rarely given to traders. The grant was often given for charitable purposes, such as the founding of a new college. Later on, in the Elizabethan period, the purpose of the grant was often to regulate a particular trade. With the development of international and colonial trade in the fifteenth century, “merchant ventures” developed. These ventures gave rise to regulated companies where each member traded his own stock, but as a member of the “company”. The interests of merchants did not lie in separate legal personality, but rather in the exercise of governmental power and trading privileges.

⁷ This is similar to ceremonial and social activities of the free masons, for example. See Farrar & Hannigan *Company Law* 15.

⁸ Farrar & Hannigan *Company Law* 15.

⁹ Lombard “n Historiese Perspektief 1” 238.

¹⁰ Farrar & Hannigan *Company Law* 15–16.

¹¹ There is some evidence that Papal Charters were also given to religious and educational bodies. See Farrar & Hannigan *Company Law* 16.

The next development was the concept of joint stock. In a joint stock company, the company trades as a single person with stock that is contributed by its members.¹² The East Indian Company was the first company to combine incorporation, overseas trade and joint stock raised from the general public. Historically, this was linked to the grant of a monopoly. A grant was made to a “company” of individuals who raised stock for the exploitation of the monopoly. Not all joint stock ventures obtained incorporation and some operated as partnerships. In 1694 a group of individuals lent money to the government and their company was, in turn, incorporated as a joint stock company. The underlying idea was that the money lent to the State constituted a fund of credit against which loans could be made by the bank. In time a company might venture to take over the whole national debt. Dealings in stocks and shares in incorporated and unincorporated ventures began on the developing stock market in 1696. It is against this background that the South Sea Bubble Act should be considered.¹³

2.2 The South Sea Bubble Act

In 1711 a lawyer formed a company called “the company of merchants of Great Britain trading in the South Seas”.¹⁴ The main object of this company was to secure trade in the South Sea. The company was very profitable and paid anyone who had a government annuity the amount that was due on it. Payment was not in cash, but in shares in the company. In 1720 the bubble burst and investors realised that they had paid much more for the shares than they were worth. The Bubble Act¹⁵ then came into operation and prohibited a company from acting as a body corporate and from raising stocks without the legal authority of a Royal Charter or Act of Parliament. It was difficult to obtain a Royal Charter and “deed of settlement companies” were established.¹⁶ This type of company was a combination between a trust and an

¹² Morse et al. *Charlesworth's Company Law* 5.

¹³ Hahlo & Farrar *Cases and Materials* 5, 17.

¹⁴ Farrar & Hannigan *Company Law* 18–19.

¹⁵ 6 Geo 1, c 18.

¹⁶ Farrar & Hannigan *Company Law* 19.

association. Its assets were held on trust, but its business was managed by the directors. The investor would obtain an interest in the trust fund. The Bubble Act was repealed in 1825. Until 1843 there was still doubt concerning the “deed of settlement companies” in terms of the common law, due to a provision in the repealing Act which stated that the position of these companies should be as it was before the Act.

2.3 The United Kingdom’s Accession to the Common Market

In 1844 people realised that there was a need for legislation providing for registration of deeds of settlement documents. This legislation was the first companies legislation. The companies formed under the 1844 Act were unlimited companies. The shareholders had unlimited liability for the debts of the company. Limited liability was introduced with the Limited Liability Act of 1855. The practice developed and there were major reforms almost every 20 years.¹⁷ The Companies Act of 1948¹⁸ was the last consolidating Act before the 1985 Companies Act.¹⁹

2.4 From 1973 Until 2007

In January 1973 the United Kingdom became a member state of the European Communities. The communities were the European Economic Community, the European Coal and Steel Community and the European Atomic Energy Community. The United Kingdom joined the European Economic Community in January 1973. The basic guiding principle of the European Economic Community is to establish undistorted competition in an undivided market, by way of treating nationals of member states equally.²⁰ In November 1993 the European Community became the European Union, following the Maastricht Treaty on the European Union.²¹ The United Kingdom’s membership to the European Union resulted from Treaties of

¹⁷ See, for example, the Companies Act of 1862 which introduces companies limited by guarantee and unlimited companies. This remained the principal Act until 1908. The Directors’ Liability Act of 1890 introduced the rule that a director could be held liable for false statements in a prospectus.

¹⁸ 11 & 12 Geo 6 c 38.

¹⁹ Hahlo & Farrar *Cases and Materials* 7.

²⁰ Farrar & Hannigan *Company Law* 26.

²¹ The Treaty on the European Union (Maastricht Treaty) O.J.C 191 of 29.7.1992.

Accession, which were given internal effect through the European Communities Act of 1972. This Act provided for the recognition and enforcement of enforceable community rights created or arising by way of, or under, the treaties. The Treaty of Rome is important here, so too further treaties created thereunder or by way of amendment. The United Kingdom was therefore subject to the Treaty of Rome which dealt, *inter alia*, with the harmonisation of company laws in Europe.

Article 2 of the Treaty of Rome sets out the goals of the European Union, namely to establish a common market and progressively approximating the economic policies of member states; to promote throughout the community a harmonious development of economic activities; a continuous and balanced expansion; an increase in stability; an accelerated raising of the standard of living; and closer relations between the states belonging to it. Article 3 provides that for the purposes set out in article 2, the activities of the European Union shall include, *inter alia*, the abolition, as between member states, of obstacles of freedom of movement for persons, services and capital; and the approximation of the laws of the member states to the extent required for the proper functioning of the common market. Article 100 is a general provision on the approximation of laws stating that the council shall issue directives for the approximation of provisions laid down in law, regulation or administrative action in member states and directly affecting the establishment or functioning of the common market.²²

Directives concerning harmonisation of company law in the European Union were issued between 1968 and 1989, and include the following:²³ The First Directive²⁴ mainly dealt with the *ultra vires* doctrine and directors' authority. In section 9 of the European Communities Act of 1972 the United Kingdom implemented the First Directive into United Kingdom company law. The Companies Act of 1980 implemented the Second Directive relating to share capital and classification of

²² See Farrar & Hannigan *Company Law* 28–29 on the harmonisation of European company law. See also Delpont “European Community Directives” 199.

²³ Hannigan *Company Law* 38–57 on the directives.

²⁴ The First Directive 68/151/EEC.

companies.²⁵ The Companies (Mergers and Divisions) Regulation of 1987 implemented the Third Directive dealing with internal mergers within member states.²⁶ The Companies Act of 1981 implemented the Fourth Directive²⁷ on company accounts.²⁸ The United Kingdom is one of the member states that have been most effective in translating directives into national law.²⁹

In 1985 a major reform was launched to restate the law in more modern language. The result was the 1985 Companies Act.³⁰ This Act was not a complete codification of company law.³¹ The fiduciary duties of directors were mainly contained in case law.

In 1998 the government set up an independent body, the Steering Group, to manage a comprehensive company law review process. The Steering Group published a number of consultation documents between 1999 and 2001, and published a *Final*

²⁵ The Second Directive 77/91/EEC.

²⁶ The Third Directive 78/855/EEC. See s 427A and Schedule 15A in the Companies Act of 1985, which inserted this directive into United Kingdom company law.

²⁷ The Fourth Directive 78/660/EEC.

²⁸ See Farrar & Hannigan *Company Law* 22–23 and Delpont “European Community Directives” 200ff on these directives. See also the Draft Fifth Directive, first proposed in 1972, dealing with worker participation on board level. The Sixth Directive 82/891/EEC on scissions or divisions (where a public company transfers all its assets and liabilities to a number of public companies within the same member state in exchange for the issue of shares to the shareholders of the original company). This directive was implemented by the Companies (Mergers and Divisions) Regulation 1987. The Seventh Directive 83/349/EEC deals with group accounts and the Eighth Directive 84/253/EEC with the qualifications and independence of auditors (both these Directives were implemented by the Companies Act of 1989). A Draft Ninth Directive deals with group relationships. No action has been taken on this directive. A proposal for a Tenth Directive was submitted during 1985 to facilitate a Community-wide type of merger, referred to in the Third Directive. Negotiations on this directive have been blocked. The Eleventh Directive 32 OJ 1989 deals with disclosure requirements in respect of branches opened in member states by companies governed by the law of another state. This directive was implemented in 1992. The Twelfth Directive 32 OJ 1989 allows for private companies with one member. Lastly, a proposal was submitted during 1989 for a Thirteenth Directive dealing with takeovers. An amended proposal was issued in 1996, but not accepted as yet.

²⁹ Farrar & Hannigan *Company Law* 37.

³⁰ See Farrar & Hannigan *Company Law* ch 2 for a concise summary on the history of English company law.

³¹ It was more of a consolidation of statutory provisions as contained in the 1948, 1967, 1976, 1981 and 1982 Companies legislation. Other legislation such as the Company Directors’ (Disqualification) Act of 1986 also played a role.

Report in 1999.³² The government responded to these documents in a *White Paper* in 2002 and again in 2005. In 2006 the Companies Bill was issued and the Act was promulgated in 2006. Some parts of the Act are already in force.³³ The remainder will be effective by October 2009. The consultation documents and the development of the review process are discussed in detail later in this chapter.³⁴

3 THE POSITION RELATING TO DIRECTORS' DUTIES PRIOR TO THE COMPANIES ACT OF 2006: AN OVERVIEW

As stated before, the Companies Act of 2006 provides for a new restatement of directors' duties. This new code of directors' duties is discussed in paragraph 4.3 below. It is, however, necessary to examine briefly directors' duties as they applied before the enactment of the Act. This is necessary mainly because the common law principles concerning directors' duties are still relevant when interpreting the new code of directors' duties. Some directors' duties are still uncodified, such as the duty to consider the interests of creditors in certain instances.³⁵ The common law therefore continues to be important when evaluating these duties.³⁶ Directors' fiduciary duties and their obligations of care and skill are discussed separately below.³⁷

3.1 The Fiduciary Duty of Good Faith

The fiduciary duties of good faith and loyalty are classified in different ways by different commentators, but these duties are usually classified into five categories. It

³² *Modern Company Law for a Competitive Economy: Final Report Volume 1 and 2* URN 01/942 and URN 01/943 released in July 2001 (hereafter the *Final Report*).

³³ See par 4.3.1 below.

³⁴ See Rickford "A History of the Company Law Review" 3–37; Eilís *Progress Report* for a discussion on the company law reform process.

³⁵ This is discussed in par 4.3.4 below.

³⁶ See the *Explanatory Notes on the Act* par 306. See also *Corporate Update: Special Client Briefing* (November 2006) by solicitors Clifford Chance on the Companies Act of 2006 at p 2.

³⁷ See generally on directors' duties Lowry & Dignam *Company Law* 290–347; Davies *Introduction to Company Law* 5–9.

is important to discuss the origin and basis of fiduciary duties briefly before considering the different fiduciary duties of directors.³⁸

The fiduciary obligation, as a legal principle, originated in English rules of equity. The original fiduciary was the trustee. There have been many attempts to define the concept “fiduciary”. The point of departure is that a fiduciary is someone who acts for, or on behalf of, another person in a relationship of confidence and trust.³⁹ Two characterises are present when defining a fiduciary relationship. Firstly, the fiduciary should have scope to exercise some discretion or power and, secondly, the fiduciary must exercise the power in such a way that the interests of beneficiaries are affected. Basically, a fiduciary relationship will arise when a person has access to assets of a trusting party and the trusting party is vulnerable to the exercise of power at the discretion of the fiduciary.⁴⁰ Other fiduciary relationships that involve trust and confidence were also recognised. Fiduciary relationships may, for example, arise in a commercial context. The position of a director, as a fiduciary, is often compared to that of trustees or agents. Directors are, however, not trustees or agents, but there are similarities between these fiduciary positions. The relationship between a director and a company remains separate.

The first category of directors’ fiduciary duties relates to the duty to act in good faith and in the best interests of the company.⁴¹ The “company” has traditionally been interpreted as the shareholders collectively.⁴² Broadly, “good faith” in this context relates to fair conduct. Directors must exercise their powers for the benefit of the

³⁸ Havenga *Fiduciary Duties of Company Directors* 7–11; DeMott “Fiduciary Obligations” 880; Finn “Fiduciary Obligations” 64; Gautreau “Fiduciary Principle” 1; Gill “Fiduciary Duties” 122 on the basis and origin of fiduciary duties.

³⁹ Mayson et al. *Company Law* 447–449; Morse et al. *Charlesworth’s Company Law* 294–295; Pettet *Company Law* 164–165.

⁴⁰ See Flannigan “Fiduciary Doctrine” 322; 449; Gautreau “Fiduciary Principle” 7 on the definition of “fiduciary”.

⁴¹ See generally on this duty, Farrar & Hannigan *Company Law* 383–391; Mayson et al. *Company Law* 454–463; Pennington *Company Law* 709; Dine & Koutsias *Company Law* 177–179; Davies *Gower and Davies’ Principles of Modern Company Law* 371; Sealy *Cases and Materials* 299.

⁴² See par 3.1.1 below where the traditional definition attached to “the company” is discussed in more detail.

company and not seek any collateral benefit for themselves.⁴³ The test to determine whether a director acted in the best interests of a company is subjective.⁴⁴ The court will not intervene, but will leave decisions relating to what is in the best interests of the company to the business judgment of the specific director.⁴⁵ A court will only interfere when no reasonable director could have concluded that a particular action was in the best interests of the company.⁴⁶ When acting in the best interests of the company, directors must act in the best interests of the present and future shareholders collectively.⁴⁷ Directors may also consider the interests of employees, creditor, consumers and other interest groups, but only when they will ultimately advance the interests of the shareholders.⁴⁸

It is the above-mentioned duty to act in the best interests of the company that is the focal point of this thesis. The duty is discussed in some detail below when considering how the different codes of corporate governance, the documents published as part of the company law review process and the Companies Act of 2006 address the stakeholder debate.

⁴³ Pettet *Company Law* 164–165.

⁴⁴ Mayson et al. *Company Law* 455; Morse et al. *Charlesworth's Company Law* 297–300.

⁴⁵ See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) at 832, where the court held that courts will not act as a kind of supervisory board over decisions within the powers of the management that they honestly arrived at. See also *Regentcrest plc v Cohen* (2001) 2 BCLC 80 (CD) at 105 (the question was whether the director had honestly believed that his act or omission was in the best interests of the company. The issue was as to the directors' state of mind).

⁴⁶ See Mayson et al. *Company Law* 454–456; *Re a Company, Ex Parte Burr* [1992] BCLC 724 (CD); *Charterbridge Corporation Ltd v Lloyds Bank Ltd* (1970) Ch 62 at 74. See generally Havenga *Fiduciary Duties of Company Directors* 63 where she discusses the English law on this topic.

⁴⁷ See Morse et al. *Charlesworth's Company Law* 297; Mayson et al. *Company Law* 457. Directors should not act in the best interests of their fellow directors, see *Lee v Chou Wen Hsien* [1985] BCLC 45 (PC); *Brant Investments Ltd v KeepRite Inc* (1988) 80 DLR 161; *Kohn v Meehan* (2003) LTL All ER 315 (D). See also *JJ Harrison (Pty) Ltd v Harrison* (2001) EWCA Civ 1467 (CA) where Judge Chadwick said that “[t]he powers to dispose of the company's property, conferred upon the directors by the articles of association, must be exercised by the directors for the purpose, and in the interests, of the company”. In *Item Software (UK) Ltd v Fassihi* (2004) EWCA Civ 1244 (CA) Judge Arden spoke of the duty of good faith as “the fundamental duty to which a director is subject, that is the duty to act in what he in good faith considers to be in the best interests of his company”.

⁴⁸ The position of these stakeholders is discussed in more detail in pars 3.1.2–3.1.6 below. See generally, Birds et al. *Boyle & Birds' Company Law* 500–501; Sealy *Cases and Materials* 262–269; Mayson et al. *Company Law* 458–463; Keenan & Bisacre *Company Law* 362–367.

The second category of directors' fiduciary duties relates to directors' duty to exercise the powers vested in them for a proper purpose.⁴⁹ Directors should use their powers for the benefit of the company and not to their own advantage. A company's memorandum of association limits the capacity of the company. Directors should observe any limitations on their powers in the memorandum. Shareholders may, however, ratify actions of directors that went beyond the powers conferred on them by the memorandum in terms of a special resolution. Directors are liable if they exceed their authority and their powers exercised for an improper purpose may be set aside.⁵⁰ Directors may even be liable if they have acted honestly, but for an improper purpose.⁵¹ In the case of *Howard Smith Ltd v Ampol Petroleum Ltd*⁵² two shareholders between them held 55 per cent of the shares in a company. They announced that they would vote against any offer from a bidder in an intended takeover. The board of directors then allotted new shares to the bidder. The Privy Council found that the board had acted for an improper purpose, even though the directors had acted honestly (and not in any self-interest). They had used the shares purely for the purpose of destroying an existing majority. The case of *Hogg v Cramphorn Ltd*⁵³ is also relevant in this regard. Directors of the defendant company feared a takeover bid and their subsequent removal from the board of directors. Based on this fear they allotted shares to persons who would support them in office. Although they believed that it would be in the best interests of the company to preserve their positions on the board, the court found that the directors had acted for an improper purpose and declared the allotment of the shares to be voidable.⁵⁴

⁴⁹ On the proper purpose rule see Keenan & Bisacre *Company Law* 357; Morse et al. *Charlesworth's Company Law* 299–302; Sealy *Cases and Materials* 302–303; Dine & Koutsias *Company Law* 201–202. See the discussion in par 4.3.2 below on directors' duties in terms of the Companies Act of 2006.

⁵⁰ Farrar & Hannigan *Company Law* 391.

⁵¹ Morse et al. *Charlesworth's Company Law* 300; Havenga *Fiduciary Duties of Company Directors* 64–67.

⁵² [1974] AC 821 (PC). See Sealy *Cases and Materials* 306–307, who holds that if directors are motivated by more than one purpose regard is to be had to the *primary* purpose in deciding whether the court will intervene or not.

⁵³ [1967] Ch 254. See Sealy *Cases and Materials* 303. In some cases “improper purpose” and “improper motive” are used interchangeably. In the *Hogg* case, however, it was found that the directors had acted with the necessary good faith, but that their “purpose” was still “improper”.

⁵⁴ Buckley J in *Hogg v Cramphorn Ltd* distinguishes between the duty to act for a proper purpose and the duty of good faith (at 266–268). The duty to act in good faith requires a subjective test, whereas the

Third, directors are regarded as “trustees” of the company’s property that is under their control and they will be liable for any misapplication thereof. A misapplication in this context means any disposition of the property of the company which the directors are forbidden, incompetent or unauthorised to make in terms of the constitution of the company, a statutory provision or a general rule of law.⁵⁵

Directors are not allowed to enter into any engagements in which they may have a personal interest that will conflict or may possibly conflict with that of the company.⁵⁶ If a company enters into a contract in which one of its directors has an interest, the contract is voidable at the option of the company.⁵⁷ The members of the company can, by way of a general resolution, permit a director to benefit from a transaction with the company, provided there has been full disclosure of all material facts. A director has a fiduciary,⁵⁸ as well as a statutory duty,⁵⁹ to disclose any

duty to act for a proper purpose requires an objective test. See also *Punt v Symons & Co Ltd* [1903] 2 Ch 506 where it was held that it is improper for directors to use their powers to issue shares in order to rob the existing majority shareholders of their voting control. This case was followed in *Piercy v S Mills & Co Ltd* [1920] 1 Ch 77. See also Havenga *Fiduciary Duties of Company Directors* 66 n 80; Birds et al. *Boyle & Birds’ Company Law* 504–506; Palmer *Annotated Guide* 165–169 on these cases.

⁵⁵ See Birds et al. *Boyle & Birds’ Company Law* 506–508 for further examples of misapplications. See also *In Re Exchange Banking Company* (1882) 21 Ch D 519 (CA) and *Allied Carpets Group plc v Nethercott* [2001] BCC 81 regarding the payment or recommendation to pay dividends out of the capital and *Rolled Steel Products (Holdings) v British Steel Corporation* [1985] 2 WLR 908 (CA) regarding the execution of a guarantee and debenture in breach of the articles and not in the *bona fide* interests of the company. See also Havenga *Fiduciary Duties of Company Directors* 74–76 who discusses this duty in the context of English law.

⁵⁶ On the duty not to have conflicting interests, see Mayson et al. *Company Law* 463–465, 470–477; Morse et al. *Charlesworth’s Company Law* 302–305; Pettet *Company Law* 166–167.

⁵⁷ *Gray v New Augarita Porcupine Mines Ltd* (1952) 3 DLR 1 at 12–13.

⁵⁸ On the fiduciary duty of a director to disclose conflicting interests see: *Bentinck v Thomas Fenn* (1887) 12 App Cas 652 (HL) at 661, 667, 671.

⁵⁹ These duties, in general law, were supplemented by a number of duties in part X of the 1985 Companies Act. See s 317(1) of the Companies Act of 1985. A director of a company who is in any way, whether directly or indirectly, interested in a contract, or proposed contract, with the company must declare the nature of the interest at a meeting of directors of the company. A declaration of interest by a director does not in itself relieve a director from the operation of the no-conflict rule. Only the members of the company can disregard that rule by way of a general provision in the articles of association or by way of ratifying a specific transaction. See *North-West Transportation Co Ltd v Henry Beatty* (1887) 12 App Cas 589 (PC) on the principle that a company may ratify a director’s breach of his fiduciary duty not to have conflicting interests in a general meeting. Non-compliance by a director of his statutory obligation in s 317(1), referred to above, does not render the contract void, but voidable under the principles of equity: see *Hely-Hutchinson v Brayhead Ltd* (1968) 1 QB 3 All

material interests in a transaction to the company. A conflicting interest will be present if the reasonable man, when considering the relevant facts, would think that there is a possible conflict of interest. An example of a possible conflict of interest is when a contract is concluded with the director's own company.⁶⁰

Lastly, a director will be accountable for any "secret profit" made through holding the office of director.⁶¹ A secret profit relates to the situation where a director makes a profit using a corporate asset to make that profit.⁶² The general prohibition on the acquisition of "secret profits" is applicable to, *inter alia*, any secret commission or "bribe" received by a director in the course of negotiating transactions on behalf of the company⁶³ or a profit derived due to the use of confidential information by the director.⁶⁴ This is clearly a breach of a director's fiduciary duties.⁶⁵ The fact that the company itself could not have made the profit is immaterial.⁶⁶ *Regal (Hastings) Ltd v*

ER 98 (Court of Appeal). See the discussion in par 4.3.2 below on the provisions of conflicting interests in the Companies Act of 2006.

⁶⁰ See *Aberdeen Rail Co v Blaikie Bros* (1854) 1 Macq 461 at 471: "no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may conflict, with the interests of those whom he is bound to protect"; *Transvaal Lands Co v New Belgium Land and Development Co* [1914] 2 Ch 488 and *Boardman v Phipps* [1967] 2 AC 46 (HL) confirming that there should not be a conflict between the personal interests of the director and the interests of the company. See also Birds et al. *Boyle & Birds' Company Law* 508–509; *Sealy Cases and Materials* 270–279.

⁶¹ This principle is equally applicable to former directors, if they have obtained the profit from an opportunity that the company is still actively pursuing; *Island Export Finance Ltd v Umunna* [1986] BCLC 460 and *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704.

⁶² See *Keech v Sandford* (1726) SelCas Ch 61 and *Keith Henry & Co Pty v Stuart Walker & Co Pty* [1958] CLR 342 where it was stated that a trustee may not use his position as trustee to make a profit for himself. It was stated that this rule applies to all cases where a relationship of trust is present.

⁶³ *Boston Deep Sea Fishing and Ice Cold Ltd v Ansell* (1888) LR 9 Eq 480.

⁶⁴ *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734.

⁶⁵ See on the "secret profit" rule: Mayson et al. *Company Law* 472–477; Morse et al. *Charlesworth's Company Law* 302–303; *Sealy Cases and Materials* 279–290.

⁶⁶ See *Gencor ACP Ltd v Dalby* (2000) 2 BCLC 734 (Ch). See further *Industrial Development Consultants Ltd v Cooley* (1972) 1 WLR 443. In this case all of the following elements were present: that what the defendants diverted for their own benefit was a "maturing business opportunity", which the company was pursuing, the defendants were participants in the negotiations, they resigned to acquire the opportunity for themselves and it was their positions in the company, rather than a "fresh initiative" that led to their acquiring the opportunity at a later stage. See also *Sealy Cases and Materials* 287.

*Gulliver*⁶⁷ is a leading decision in this regard. The directors of the appellant company, who owned a cinema, wanted to acquire two more cinemas. A subsidiary company was formed to acquire the two cinemas. The capital of the company was 5 000 shares issued at a par value of £1 each. A lease of two cinemas was offered, provided that the subsidiary company's capital was paid up. It was the intention of the directors of the appellant company that the appellant company should own all the shares in the subsidiary company. The appellant company could, however, only afford to invest £2 000. Accordingly, the directors and the solicitor each took 500 shares. Three other investors also bought 500 shares each. Subsequently, the shares in the company and the subsidiary company were sold, and the new shareholders sought to hold the directors and the solicitor liable for the profit they made in respect of the subsidiary company's shares. The House of Lords held that they were liable for the profits made.⁶⁸ The directors made use of a corporate opportunity that the company was unable to make use of. The directors acquired the profits only by reason of their holding the office of directors. It did not make a difference that they had acted in good faith and tried to assist the company in acquiring the opportunity.⁶⁹

3.1.1 The Traditional Position: Directors' Duties Owed to Whom?

The fiduciary duty of a director to act in the best interests of the company is central to this thesis. It is necessary to refer to the traditional position regarding the interpretation of this duty. It was stated above that the general rule is that directors owe their fiduciary duties to the company as a whole⁷⁰ and this has been interpreted

⁶⁷ [1942] 1 All ER 378 (HL). See *Sealy Cases and Materials* 280; Keenan & Bisacre *Company Law* 354–356 on this case.

⁶⁸ See Dine & Koutsias *Company Law* 187; Birds et al. *Boyle & Birds' Company Law* 524–525 for a summary of the facts.

⁶⁹ See Hadjinestoros "Exploitation of Business Opportunity" 70–77. The United Kingdom is applying a wide view of what the "company's interests" are and will likely find that a reasonable possibility of conflicting interests exist. He indicates, furthermore, that the new Companies Act also provide no guidelines on how to interpret a "corporate opportunity".

⁷⁰ See par 3.1 above. See also *Sealy Cases and Materials* 259–261; Morse et al. *Charlesworth's Company Law* 297–299; Mayson et al. *Company Law* 454ff; Dine & Koutsias *Company Law* 189–190. These authorities confirm that traditionally directors owe their duties to the company and thus the members as a body and not to other stakeholders such as employees, creditors or individual stakeholders. See also a document issued by the GC100. The GC100 is the senior legal officers of more than 70 FTSE100 (Financial Times Stock Exchange top 100 highly capitalised companies on the London Stock Exchange) companies collectively. The GC100 document is available at <http://www.practicallaw.com/jsp/binaryContent.jsp?item=:29689743> (accessed 14 November 2007).

as the present and future shareholders collectively, and not to any third parties directly.⁷¹ When considering the interests of both future and present members, directors should balance the long-term view against the short-term interests of the members.⁷² Directors do not owe their fiduciary duties to individual members.⁷³ There has, however, been a shift in public opinion to include the interests of other stakeholders.⁷⁴ In the next section the protection currently afforded other stakeholders is considered. The discussion is restricted to employees, creditors, individual shareholders and consumers. Later in this chapter the new Companies Act is discussed, section 172(1) is evaluated and it is considered whether or not this section provides stakeholders with adequate protection.

This document discusses directors' duties in terms of the Companies Act of 2006 and also refers to the traditional position. It is stated that, in terms of the traditional position, directors must act in such a way that they believe it to be in the best interests of the company and its shareholders, both current and future. The duty is owed to the company as a whole and not to individual shareholders (see par 2 of the GC100 document). See further Attenborough "The Company Law Reform Bill" 163: "Many commentators traditionally view United Kingdom company law as adhering to the shareholder primacy or shareholder conception of the company." He then refers to Macey & Miller "Corporate Stakeholders" 401; Hansman & Kraakman "The End of History for Corporate law" 441 who indicate that there is "no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value". See further Siems "Shareholders, Stakeholders" 147–159; Deakin "Transformation of Shareholder Value" 11. Arsalidou "Shareholder Primacy" 67 also discusses the traditional position that directors should manage a company in the best interests of the shareholders collectively.

⁷¹ See the discussion in ch 6 par 2.1.1 where the position traditionally applied in South Africa is considered. See generally *Gaiman v National Association for Mental Health* [1971] Ch 317 at 330; Dine & Koutsias *Company Law* 178–179; Birds et al. *Boyle & Birds' Company Law* 499; Davies *Gower and Davies' Principles of Modern Company Law* 371–379; Farrar & Hannigan *Company Law* 380–391.

⁷² Beuthin & Luiz *Company Law* 199.

⁷³ See *Percival v Wright* (1902) 2 Ch 421 in this regard. See also on the protection of individual shareholders: Mayson et al. *Company Law* 457ff; Pettet *Company Law* 164–165; Dine & Koutsias *Company Law* 190; *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* (1983) Ch 258 at 288; *Heron International Ltd v Lord Grade, Associated Communications Corp plc* (1983) BCLC 244 (CA) at 330. See further ch 6 par 3.1 where these cases are referred to in the South African context.

⁷⁴ Morse et al. *Charlesworth's Company Law* 297–298.

3.1.2 Individual Shareholders

It was stated above that directors should act in the best interests of the shareholders collectively.⁷⁵ Directors do not have direct fiduciary duties to individual shareholders.⁷⁶ In *Allen v Hyatt*⁷⁷ it was held that directors may become agents of the members for a particular transaction, in which case the situation of agency gives rise to fiduciary duties. In *Platt v Platt*⁷⁸ it was stated that the relationship between a director and an individual shareholder does not in itself give rise to fiduciary duties, but special circumstances may impose such a duty. It was confirmed in *Peskin v Anderson*⁷⁹ that in the absence of a special relationship, directors will not have fiduciary duties towards individual shareholders.⁸⁰

3.1.3 Creditors

A number of cases deal with the protection of creditors and whether or not directors should have a fiduciary duty to protect their interests.⁸¹ They are discussed below. Arguments concerning an extension of directors' fiduciary duties to creditors and some of the difficulties with the arguments of the different courts in the cases dealing with directors' fiduciary duties to creditors are mentioned briefly here, but discussed and evaluated in detail in chapter 6.⁸² There is no South African case law on

⁷⁵ See Schall et al. "Promoting an Inclusive Approach" 300–304 stating that directors do not have a general duty to consider the interests of creditors, employees or consumers. Their duty is to the shareholders as a "general body".

⁷⁶ Paragraph 3.1.1 above.

⁷⁷ (1914) 30 TLR 444.

⁷⁸ (1999) 2 BCLC 745 (CD).

⁷⁹ (2001) 1 BCLC 372 (CA).

⁸⁰ See Keenan & Bisacre *Company Law* 364–365; Sealy *Cases and Materials* 262–264 on the *Allen v Hyatt*, *Platt* and *Peskin* cases.

⁸¹ See also ch 4 par 3.2.3 for Australian case law on the protection of creditors and ch 6 par 3.2 where the possibility of a duty to creditors is evaluated. See further on the interests of creditors, Sealy "Directors' Wider Responsibilities" 164; Grantham "The Judicial Extension of Directors' Duties to Creditors" 13; Keay "Interests of Company Creditors: When is it Triggered?" 315; Keay "Directors' Duties to Creditors" 665; Keay "The Duty to Creditors" 379; Keay *Directors Taking into Account Creditors' Interests* 300; McKenzie-Skene "Directors' Duty to Creditors" 499. See generally on the protection of creditors, Dine & Koutsias *Company Law* 190; Sealy *Cases and Materials* 267–269; Morse et al. *Charlesworth's Company Law* 297–298; Mayson et al. *Company Law* 460–462; Keenan & Bisacre *Company Law* 366.

⁸² Paragraph 3.2.

directors' duties to creditors. It is therefore important to rely on case law in other jurisdictions to determine whether directors should have a direct fiduciary duty to creditors in terms of South African company law.

Most of the English decisions confirm that directors have an indirect duty to consider the interests of creditors when a company is “nearing” insolvency. In *Lonrho v Shell Petroleum* Lord Diplock said that “[i]t is the duty of the board to consider . . . the best interests of the company. These are not exclusively those of its shareholders, but may include those of its creditors”.⁸³ This viewpoint was confirmed in the decision in *The Liquidator of the Property of West Mercia Safetywear Ltd (in liq) v Dodd and Another*⁸⁴ made in 1988. In this case, the interests of the company were found to include the interests of creditors, because the company was insolvent. The court adopted into English law a principle that had previously been enacted into Australian and New Zealand law.⁸⁵ In *Horsley & Weight Ltd* one of the instances where creditors' interests may be important was discussed. The court stated that a director owes an indirect duty to creditors not to permit any unlawful reduction of capital.⁸⁶ In *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* it was held that directors do not owe fiduciary duties to creditors, but to the company. It was stated that when a company is solvent, neither it nor its directors owe any duty to its creditors.⁸⁷

However, in *Winkworth v Edward Baron*⁸⁸ the court referred to a duty directly owed to creditors by directors. Lord Templeton said the following:

⁸³ (1980) 1 WLR 627 at 634.

⁸⁴ (1988) BCLC 250 (CA).

⁸⁵ See the following Australian and New Zealand decisions: *Walker v Wimborne* (1976) 137 CLR 1 (HC); *Ring v Sutton* (1980) 5 ACLR 546; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 10 ACLR 395; *Jeffrey v National Companies & Securities Commission* (1989) 15 ACLR 217; *Spies v The Queen* (2000) 201 CLR 603 (HC); *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA). These decisions are discussed in detail later in ch 4 par 3.2.3.

⁸⁶ [1982] 1 Ch 442 (CA) at 442.

⁸⁷ [1983] Ch 258 at 288.

⁸⁸ [1987] 1 All ER 114 (HL).

[A] company owes a duty to its creditors, present and future. The company owes a duty to its creditors to keep its property inviolate and available for repayment of its debts. The conscience of the company, as well as its management, is confided to its directors. A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors.⁸⁹

It is, however, unlikely that such a change of the prevailing position was intended by Lord Templeton as authorities in this area were not even considered by him.⁹⁰ Subsequent courts also did not follow his *dictum*.⁹¹

These cases seem to indicate that directors should consider the interests of creditors, at least in cases of doubtful solvency.⁹² When a company is insolvent or near insolvency, the interests of the company and the interests of the creditors coincide to a considerable degree.⁹³ The duty of directors to consider the interests of creditors where a company is financially distressed is therefore regarded as a well-established principle, but important aspects of this duty are still unclear. It is uncertain at precisely what stage directors should consider the interests of creditors. It is also unclear what the position is in the case of a solvent company and what weight directors should give to the consideration of the interests of creditors⁹⁴ and whether or

⁸⁹ At 118. See also Farrar & Hannigan *Company Law* 384; McKenzie-Skene “Directors’ Duty to Creditors” 501. The existence of a duty to consider the interests of creditors was also recognised in *Brady v Brady* (1987) 3 BCC 535 (CA). See also, more recently, *Re MDA Investment Management Ltd* (2004) 1 BCLC 217 (CD). The interests of creditors should be considered when a company is insolvent or in financial difficulty. The court specifically held that this duty arises where the company “whether technically insolvent or not, is in financial difficulty to the extent that the creditors are at risk” (at 227 par 70).

⁹⁰ Davies *Gower and Davies’ Principles of Modern Company Law* 371–379; Farrar & Hannigan *Company Law* 386.

⁹¹ Davies *Gower and Davies’ Principles of Modern Company Law* 373 n 13.

⁹² See *MDA Investment Management Ltd* 783. See also Mayson et al. *Company Law* 462; *Kuwait Asia Bank EC v National Mutual Nominees Ltd* (1991) 1 AC 187 where Lord Lowry stated at 217 that: “A director does not by any reason only of his position as director owe any duty to creditors or trustees for creditors of the company.” This was later confirmed in *Yukong Line Ltd of Korea v Rendsburg Investments Corporation (No 2)* (1998) 1 WLR 294.

⁹³ *Standard Chartered Bank v Walker* (1992) 1 WLR 561.

⁹⁴ See Dine & Koutsias *Company Law* 191. These uncertainties are also discussed in detail in ch 6 par 3.2 below with reference to articles by United Kingdom as well as South African commentators. Australian and New Zealand case law are discussed at ch 4 par 3.2.3.

not this duty to creditors is an indirect or direct duty. Is it an independent duty owed directly to creditors, which creditors can enforce or is it an indirect duty owed to the company that only the company can enforce? Most commentators and case law follow the latter interpretation.⁹⁵ It is also unclear who the creditors are. Does the duty only extend to existing creditors or are future creditors also included? Most cases are silent on this issue, but in the *Winkworth* decision it was held that future creditors should also be included.⁹⁶ Lastly, it is uncertain when the duty to creditors arises.⁹⁷ Some cases do not state that a company should be in financial distress before directors will have a duty to consider the interests of creditors.⁹⁸ In the decision of *Horsley & Wreight Ltd* Lord Templeman refers to “doubtful solvency”.⁹⁹ In *West Mercia* it was stated, with reference to the decision of *Kinsela v Russell Kinsela Pty Ltd*, that the duty arises when a company is insolvent.¹⁰⁰ It therefore seems clear from most decisions that “insolvency” (and circumstances short of insolvency, such as doubtful solvency) will trigger a duty towards creditors. The cases do not, however, define what is meant by “insolvency”.¹⁰¹

The protection afforded creditors was also discussed during the United Kingdom company law reform process.¹⁰² It was argued that directors should not act in the best

⁹⁵ See *Walker v Wimborne*; *Yukong Line Ltd of Korea v Rendsburg Investments Corporation (No 2)*. The exception is *Winkworth v Edward Baron Development Co* at 118, as discussed above. See also McKenzie-Skene “Directors’ Duty to Creditors” 501–503. See ch 6 par 3.2 below on this uncertainty.

⁹⁶ At 118. See, however, *Brady v Brady* 552, where the court confirmed the duty only to existing creditors and *Nicholson v Permakraft (NZ) Ltd* at 250 where the court took the view that future creditors would normally take a company as it was and could look after their own interests. See generally McKenzie-Skene “Directors’ Duty to Creditors” 503.

⁹⁷ See ch 6 par 3.2 below on this problem.

⁹⁸ See *Walker v Wimborne*; *Lonrho Ltd v Shell Petroleum Co Ltd*; *Winkworth v Edward Baron Development Co Ltd*.

⁹⁹ *Horsley & Weight Ltd* at 442, 455.

¹⁰⁰ (1986) 10 ACLR 395. This was also stated in the *Nicholson v Permakraft (NZ) Ltd* decision at 249.

¹⁰¹ See ch 6 par 3.2 where this issue is discussed and a possible solution or test is suggested. See also McKenzie-Skene “Directors’ Duty to Creditors” 510.

¹⁰² See par 4.2.3 below on the position of creditors as discussed by the Steering Group during the company law review process. See specifically *Modern Company Law for a Competitive Economy: The Strategic Framework*, URN 99/654 (February 1999) available at <http://www.lens-library.com/info/DTI0399FINAL.html> (accessed 10 February 2008) (hereafter *Strategic Framework*)

interests of creditors. It was specifically concluded that creditors should not be listed as stakeholders to whom directors should have regard when managing a company.¹⁰³ This was mainly based on the fact that creditors receive sufficient protection in section 214 of the Insolvency Act of 1986.¹⁰⁴ It was therefore considered undesirable to have detailed new rules protecting the interests of creditors. It is, however, generally agreed that directors' duties are subject to the overriding duty towards creditors in insolvent situations, as was seen from the case law discussed above.¹⁰⁵

3.1.4 Employees

A number of cases, decided mainly in England, deal with employee interests.¹⁰⁶ The courts considered whether the specific actions of the directors were in the sole interests of the employees concerned or whether the company as a whole also benefited from the actions.

In *Hutton v West Cork Railway Company*¹⁰⁷ the court prohibited charitable activities unless a direct benefit accrued to the corporation. In this case a railway company sold its undertaking to another company at a price to be determined by an arbitrator. It was decided that the purchase price would be applied to pay the arbitration costs, paying off any revenue debts or charges to the company. The residue was to be divided between the debenture holders and the shareholders. Once the transfer had taken place, a general meeting was held where it was decided that a certain portion of the purchase price would be applied to pay compensation to officials who would lose their jobs as a result of the transfer. The court held that the company was no longer a going concern, but only existed for the purpose of being wound up and that such a

par 5.1.4; *Developing the Framework* par 2.19; *Completing the Structure* par 3.12; the *Final Report* par 3.11 and the *2005 White Paper* par 3.10.

¹⁰³ See *Dine & Koutsias Company Law* 190 stating that it is clear that shareholders collectively should still receive primacy in terms of the new s 172(1) of the Companies Act of 2006. Creditors are excluded from s 172(1). See also par 4.3.3 below on s 172(1).

¹⁰⁴ See *Developing the Framework* par 3.72. See the discussion below at par 4.2.2.2.

¹⁰⁵ See *Completing the Structure* par 3.12. See par 4.2.2.3 below.

¹⁰⁶ Most of these cases concern donations or corporate gifts to employees. See Hodes "The Social Responsibility of a Company" 475.

¹⁰⁷ (1883) 23 ChD 654 (CA).

payment of compensation was invalid. It seems, from this decision, as if directors may only have regard to the interests of employees to the extent that it would contribute to the success of the company.

*Parke v Daily News Ltd*¹⁰⁸ concerned a company, Daily News Limited, that controlled two major newspapers. The copyright of the newspapers was owed by its two wholly owned subsidiaries. The company suffered major losses. The board decided to sell the copyright they had in the newspapers, as well as the newspapers' plant and premises, to avoid further losses. The company intended to distribute the balance of the purchase price to the employees as compensation, after the transaction costs had been paid. The court declared these payments *ultra vires*.¹⁰⁹ These payments were also not regarded as in the benefit of the company as a whole.¹¹⁰ This company was also in the process of being wound up.

The *Parke* and *Hutton* decisions,¹¹¹ involving companies in the process of winding up, should be distinguished from the decision in *Hampson v Price's Patent Candle Company*¹¹² where the directors gave voluntary gifts, which were not *ultra vires*, to the employees because of the very prosperous year the company had had. The court held that this gratuity would result in a direct benefit to the company, as it would motivate employees.

¹⁰⁸ [1962] Ch 927.

¹⁰⁹ In another English decision, *Charterbridge Corporation Ltd v Lloyds Bank Ltd* (1970) Ch 62, the court also based its decision upon the issue of an *ultra vires* transaction rather than on directors' fiduciary duties. No such problems relating to capacity or powers to make donations should, however, arise in South Africa. Section 33 of the the South African Companies Act of 1973 states that a company shall have the capacity determined by the main object stated in the memorandum and that there shall be included in its capacity unlimited objects ancillary to the said main object, unless expressly excluded in the memorandum and s 34 states that every company shall have plenary powers to enable it to realise its main and ancillary objects, including the common powers in schedule 2. These common powers include the making of donations. Lastly s 36 states that no act shall be void by reason only of the fact that it is *ultra vires*. See on this issue Havenga *Fiduciary Duties of Company Directors* 45; Naudé "Section 36" 315; Hodes "The Social Responsibility of a Company" 476.

¹¹⁰ Mackenzie "The Employee and the Company Director" 688; Havenga *Fiduciary Duties of Company Directors* 43; Hodes "The Social Responsibility of a Company" 468–469.

¹¹¹ Beuthin "The Range of a Company's Interests" 160–161.

¹¹² (1876) 45 L.J Ch 437.

In the end, the legal justification for gifts or any other benefit that directors may allow employees to acquire is the ultimate benefit of the company as a whole. For instance, directors can provide employees with pension benefits if the object is to attract loyal employees, because it will be to the benefit of the shareholders.¹¹³ It is clear from these cases that the concept of the company as a whole is of paramount importance in England where directors manage a company. Section 309 of the previous Companies Act of 1985 is relevant in this regard. Section 309 provided that the matters to which directors were to have regard when they managed a company included the interests of the company's employees in general. The duty imposed by this section was still owed to the company and was enforceable in the same way as any other fiduciary duty owed to a company by its director.¹¹⁴ Employees could not enforce this duty themselves, and the duty was owed to the company and not to the employees directly. The interests of employees did not receive primacy over those of the shareholders collectively. It was also very difficult to prove that directors did not have regard to the interests of employees. This provision was therefore an attempt to include the interests of employees, but was without any teeth.¹¹⁵ Employees are, however, now listed in the new section 172(1) of the United Kingdom Companies Act of 2006 as a factor that directors must have regard to when managing a company, but they are not awarded with specific remedies to enforce their rights.¹¹⁶ The aim of section 172(1) is not to provide stakeholders with direct rights, but rather to make directors aware of the interests of stakeholders, other than shareholders. The new United Kingdom Companies Act of 2006 emphasises that companies should have a social responsibility towards their employees. A happy and stable workforce will benefit the company and its prosperity.¹¹⁷

¹¹³ Beuthin "The Range of a Company's Interests" 167–168.

¹¹⁴ See generally on the protection of employee interests, Mayson et al. *Company Law* 454ff; Sealy *Cases and Materials* 269. See also Villiers "Section 309 of the Companies Act 1985" in Collins et al. (eds) *Legal Regulation* ch 30.

¹¹⁵ Farrar & Hannigan *Company Law* 390; Schall et al. "Promoting an Inclusive Approach" 301.

¹¹⁶ See par 4.3.3 for a discussion of s 172(1).

¹¹⁷ Hodes "The Social Responsibility of a Company" 479.

Employees are also protected in various other statutes in the United Kingdom. Collective consultation between employers and their employees through recognised trade unions or elected employee representatives is required in a number of specific situations.¹¹⁸ These consultation obligations have steadily been expanded over recent years in various regulations such as the Transnational Information and Consultation of Employees Regulations of 1999,¹¹⁹ the Information and Consultation of Employees Regulations of 2004¹²⁰ and the Occupational and Personal Pension Schemes (Consultation by Employees and Miscellaneous Amendments) Regulations of 2006.¹²¹ A company's obligation to consider the effects of its decisions and actions on its employees does not, however, derive only from these consultation obligations. As stated above, directors also need to have regard to the interests of employees when exercising their fiduciary duties.¹²²

3.1.5 Consumers

Directors do not owe fiduciary duties directly to consumers,¹²³ but there are a number of reasons why consumers need to be protected. Firstly, consumers need to be protected from fraudulent trading practices. The nature of modern markets is such that consumers can no longer make prudent shopping decisions. Consumers are subject to a wide variety of technologically advanced goods and not all of them have the necessary skill and knowledge to make informed decisions on what to purchase. Secondly, advertising and marketing strategies are very sophisticated and can result in misleading or confusing information being provided to consumers. Thirdly, consumers are generally awarded with credit and they also have high disposable incomes. There are a large number of shopping malls that are easily accessible, but consumers do not always have sufficient time to do research on what they want to

¹¹⁸ See, for example, the Transfer of Undertakings (Protection of Employment) Regulations 2006 SI 2006/246 regulations 13–15, facilitated further by the Employment Relations Act 1999 s1.

¹¹⁹ SI 1999/3323.

¹²⁰ SI 2004/3426.

¹²¹ SI 2006/349.

¹²² Wynn-Evans "The Companies Act 2006 and the Interests of Employees" 188–193.

¹²³ See, generally, Keenan & Riches *Business Law* ch 14 on consumer protection in the United Kingdom.

buy. Fourthly, the underlying aim of consumer protection is to redress the balance of power between consumers and suppliers.¹²⁴

A “consumer transaction” generally has three essential elements, namely (1) an individual who purchases goods or services for its own benefit, (2) a supplier who is acting in a business capacity and (3) goods or services that must be intended for private use or consumption.¹²⁵ Consumers generally receive extensive protection. There is legislation¹²⁶ (and websites and public bodies)¹²⁷ relating to the general protection of consumers in the retail markets. The laws of competition and credit protection also provide consumers with protection. Where consumers are also creditors, they are entitled to the same protection as creditors. These different areas of protection afforded consumers are discussed briefly below. The aim of the discussion is to indicate that consumers receive extensive protection in the United Kingdom. This is an important factor in view of the theory proposed in chapter 2 above.¹²⁸ It was suggested that directors need to consider the interests of stakeholders and that other legislation protecting stakeholders should be taken into account. Directors must be aware of how other legislation protects the interests of different stakeholders when exercising their fiduciary duties.

¹²⁴ Keenan & Riches *Business Law* 414.

¹²⁵ See Keenan & Riches *Business Law* 413. The first element is usually defined in a very broad manner and includes businesses. The Unfair Contract Terms Act of 1977 provides, for example, protection to those who “deal as a consumer” in s 12(1). The courts interpreted this section to apply also to occasional purchases by a company. These purchases should, however, not be part of the main business of the specific company. See *R&B Customs Brokers Ltd v United Dominions Trust Ltd* (1988) 1 WLR 321.

¹²⁶ For example, the Enterprise Act of 2002 and the Consumer Credit Act of 2006.

¹²⁷ See, for example, the Office of Fair Trading, a non-ministerial department established in terms of the Fair Trading Act of 1973 (see www.ofl.gov.uk). At www.consumerdirect.gov.uk consumers receive advice on their rights concerning guarantees, buying on credit, refunding or cancelling of orders, dealing in disputes and unfair clauses in contracts. This website is a government-funded telephone and online service for consumers. At www.tradingstandards.gov.uk consumers are also advised on their position in the United Kingdom. This website is supported by the Trading Standards Institute. See Keenan & Riches *Business Law* 416–417.

¹²⁸ Chapter 2 par 5.2 above.

The Unfair Contract Terms Act of 1977,¹²⁹ the Competition Act of 1998, the Enterprise Act of 2002¹³⁰ and the Consumer Credit Act of 2006¹³¹ are relevant, and provide consumers with significant protection. The Unfair Contract Terms Act of 1977 deals with contracts where one party is a consumer. The Act provides that where a party is in breach of his obligations, he cannot rely on any one of the terms of the contract unless the term is reasonable. The test for reasonableness is set out in section 11 of the Act and provides that one has to have regard to the circumstances that were, or ought to have been, known or in the contemplation of the parties when the contract was made in order to determine whether a specific term is reasonable or not. The United Kingdom is also part of the European Union and the Directive on Unfair Terms in Consumer Contracts of 1999¹³² is relevant. This directive sets a framework within which firms must work when they draw up contract terms and conditions. In terms of this directive certain qualifying bodies such as the Office of

¹²⁹ See Dean “Unfair Contract Terms” 581, where she discusses the Unfair Contract Terms Act and the EC Directive (93/13) of 1993 that addresses some of the inadequacies of this Act. Dean maintains that there is a remarkable absence of case law on the Unfair Contract Terms Act. This is mainly due to its narrowness of scope and it is not widely known or used by consumers (at 589). The scope of the directive is wider and applies, for example, also to insurance contracts.

¹³⁰ The Enterprise Act of 2002 received royal assent in November 2002. The Act is divided into eleven parts and has 281 sections and 26 Schedules. Part 1 of the Act establishes the Office of Fair Trading (OFT), sets out its general functions, and provides for arrangements for making super-complaints to the OFT. Part 2 establishes and makes provisions for proceedings before the Competition Appeal Tribunal (CAT). Part 3 provides for a new merger regime, covering the definition of a qualifying merger, the duty of the OFT to make references to the Competition Commission (CC); how references are determined; the procedures that relate to certain public interest cases and other special cases; powers of enforcement; undertakings and orders; and various supplementary matters, such as information and publicity requirements and powers to require information. Part 4 makes provision for new market investigations arrangements. It sets out the power of the OFT and the Secretary of State to make references to the CC, and how the CC should report on the references. It provides for particular arrangements to apply in public interest cases, and also covers powers of enforcement and various supplementary matters. Part 5 deals with the CC, and provides for its rules of procedure. Part 6 deals with the creation of a cartel offence. Part 7 deals with a number of miscellaneous competition provisions, including powers to disqualify directors who engage in serious competition breaches. Part 8 deals with new procedures for enforcing certain consumer legislation, and miscellaneous related matters. Part 9 provides for rules to govern the disclosure of specified information held by a public authority, setting out the circumstances in which the information may be disclosed, and various related matters. Part 10 changes insolvency law by providing for a new regime for company administration and restricting the future use of administrative receivership; abolishing Crown preference; establishing a new regime for the insolvency of individuals; and making changes to the operation of the Insolvency Services Account. Part 11 contains a number of supplementary provisions, such as commencement, short title and territorial extent. (See the *Explanatory Notes on the Act* at <http://www.opsi.gov.uk/acts/en2002/2002en40.htm> (accessed 10 July 2007)).

¹³¹ The Consumer Credit Act of 2006 received royal assent in March 2006.

¹³² SI 1999/2083.

Fair Trading should ensure that the terms in a contract are not unfair and challenge a company if they are.

The Enterprise Act is also relevant and introduced a new procedure to allow certain designated consumer bodies to make super-complaints to the Office of Fair Trading. These complaints include “any feature or combination of features of a market in the United Kingdom for goods or services is or appears to be significantly harming the interests of consumers”.¹³³ The Act also changed certain aspects of competition law, consumer protection and insolvency law.¹³⁴

The Consumer Credit Act provides for the regulation of all consumer credit and consumer hire agreements subject to certain exemptions; provides for the licensing of providers of consumer credit and consumer hire and ancillary credit services, and the functions and powers of the Office of Fair Trading in relation to licensing; enables debtors to challenge unfair relationships with creditors; and provides for an Ombudsman scheme to hear complaints in relation to businesses licensed under the Fair Trading Act of 1973,¹³⁵ as amended by the Consumer Credit Act.¹³⁶

Consumers are also sometimes creditors and are therefore also protected in terms of the common law, as discussed above. There are also a further number of provisions in the Companies Act of 2006 which indirectly protect creditors. Sections 1035–1039 concern company investigations and provide that the Secretary of State has the power to give directions to a company investigator to investigate a company on a specific subject matter, a specific transaction or over a certain period of time. The Secretary

¹³³ Section 11 of the Enterprise Act.

¹³⁴ For example, as regards competition law, the Office of Fair Trading (OFT) will be given a new power to apply to the court to disqualify directors involved in breaches of competition law (part 7 s 204). Persons harmed by a breach of competition law will be able to bring claims for damages before a specialist competition body (the Competition Appeal Tribunal (part 2)). In the area of consumer protection, a new regime is established for the OFT to approve business-to-consumer codes of practice. Concerning the insolvency of individuals, provision is made for the automatic discharge of nearly all bankrupts after a maximum of 12 months (s 279).

¹³⁵ See the Fair Trading Act of 1973.

¹³⁶ See also the *Explanatory Notes* on the Consumer Credit Act at http://www.opsi.gov.uk/acts/en2006/ukpgaen_20060014_en.pdf (accessed 10 July 2007). For these Acts see www.statutelaw.gov.uk.

can also request that an inspector investigate certain documents of the company. These provisions provide creditors (and consumers) with indirect protection as it ensures insight into the company's affairs and documents. Lastly, chapter 46 of the Company Directors Disqualifications Act of 1986 provides for the disqualification of directors and other persons on a variety of grounds. This chapter does not provide creditors with a remedy, but directors can be held personally liable when acting in breach of a disqualification. It therefore enhances creditor protection by removing people from the system who do not meet the standard required to manage a company.¹³⁷

3.1.6 The Different Interest Groups: Concluding Remarks

It was argued above that directors do not have direct fiduciary duties to stakeholders. Shareholders are the primary beneficiaries when directors manage a company.¹³⁸ Protection afforded individual shareholders, creditors, employees and consumers was discussed in the previous section. Directors do not have a direct duty to individual shareholders. But special circumstances, such as agency, may impose a duty towards individual shareholders.¹³⁹

With regard to creditors, a number of cases were considered. It was indicated that most of these cases require a duty to creditors when insolvency of a company is “nearing”.¹⁴⁰

A number of cases dealing with employee interests were also considered. It was stated that the legal justification for any gift or benefit to employees should be the ultimate benefit of the company as a whole. Collective consultation between

¹³⁷ See, for example, s 6 of the Disqualifications Act stating that a court has a duty to disqualify a director who has at any time become insolvent where his conduct as a director of any other company or companies, makes him unfit to be concerned in the management of a company. See generally, McKenzie-Skene “Directors’ Duties to Creditors” 526; Du Plessis “Diskwalifikasie en Persoonlike Aanspreeklikheid” 435–441 (he discusses the regulations governing the disqualification of company directors from being involved in the management of a company).

¹³⁸ Paragraph 3.1.1 above.

¹³⁹ Paragraph 3.1.2 above.

¹⁴⁰ Paragraph 3.1.3 above.

employees and employers, as well as trade unions, is also means by which employees are protected.¹⁴¹

Consumers receive extensive protection in various statutes such as the Unfair Contract Terms Act of 1977, the Competition Act of 1998, the Enterprise Act of 2002 and the Consumer Credit Act of 2006.¹⁴²

The new Companies Act of 2006 opted for the enlightened shareholder value approach by indicating that directors should still manage a company in the best interests of the shareholders collectively.¹⁴³ A number of factors are, however, listed that directors should consider when managing a company in the best interests of the shareholders collectively. These factors include that directors should have regard to the likely consequence of any decision in the long-term; the interests of the employees; the need to foster the company's business relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly as towards various members of the company. Section 172(1) seems to provide different stakeholders with extensive protection. The Act is very clear on the preferred approach relating to the stakeholder debate,¹⁴⁴ but how it will be applied practically is still uncertain. This is discussed in detail later in this chapter.¹⁴⁵

3.2 The Duty of Care, Skill and Diligence

It is important for purposes of this thesis also to discuss this duty. It is indicated below that when directors determine whose interests they need to take into account when managing a company in the best interests of the shareholders collectively, they

¹⁴¹ Paragraph 3.1.4 above.

¹⁴² Paragraph 3.1.5 above.

¹⁴³ See s 172(1) of the Companies Act of 2006, discussed in par 4.3.3 below.

¹⁴⁴ The South African Bill of 2007, in contrast, is not clear on the preferred approach. See ch 6 par 4.3 below.

¹⁴⁵ Paragraph 4.3.3 below.

should act with the necessary care and skill. This is especially important in the context of the new section 172(1), which states that directors should consider a number of factors when managing a company.¹⁴⁶ It is argued that when directors consider these factors, they should act with the necessary care and skill. If not, they can be in breach of both their fiduciary duty to the company as a whole, as well as their duty of care and skill.¹⁴⁷

The duty of care and skill represents the courts' attempts to regulate the entrepreneurial side of directors' activities.¹⁴⁸ If directors are negligent in the performance of their duties, they will be liable for the damage caused by their negligence.¹⁴⁹ It is a duty both in equity and in the common law of tort (or delict).¹⁵⁰

The standard of care and skill expected of directors was traditionally quite low, as directors' skills were judged subjectively.¹⁵¹ In *Re City Equitable Fire Insurance Co Ltd*¹⁵² the Court of Appeal found that a director need not show a greater degree of skill when performing his duties than may be reasonably expected of a person of *his*

¹⁴⁶ Paragraph 4.3.3 below.

¹⁴⁷ Paragraph 4.3.2 below.

¹⁴⁸ See Pettet *Company Law* 161–163 on the duty of care and skill.

¹⁴⁹ *Dorchester Finance Co Ltd v Stebbing* (1989) BCLC 498 (Ch).

¹⁵⁰ *Bristol and West Building Society v Mothew* (1998) Ch 1 (CA) at 16–17; *Base Metal Trading Ltd v Shamurin* (2004) EWCA Civ 1316.

¹⁵¹ A subjective test was applied in *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425. See also *Re Forest of Dean Coal Mining Company* (1878) 10 Ch D 450, where it was held that the degree of skill of each individual will vary, but the standard of care required is such care as an ordinary man might be expected to take in the same circumstances on his own behalf. See further, Farrar & Hannigan *Company Law* 379–402; Pettet *Company Law* 160–162; Birds et al. *Boyle & Birds' Company Law* 499–503; Birds "The Reform of Directors' Duties" 152–154; Copp "Corporate Governance: Part 2" 115–128; Worthington "The Duty to Monitor" 188 referring to the tests applied by the courts concerning the duty of care and skill. The *City Equitable* decision made it quite easy for directors to escape responsibility for corporate failures by relying on factors of a subjective nature. These factors include the individual's lack of experience or specialist expertise. See Sealy *Cases and Material* 316 commenting on the *City Equitable* decision.

¹⁵² [1925] 1 Ch 407 (CA). The court reviewed some of the older cases on the duty of care and skill. The cases referred to were: *Overend Gurney & Co v Gibb* (1872) LR 5 HL 480; *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392. The court concluded that it is impossible to describe the duty of directors in general terms because of the wide variety of companies and functions that would be encompassed (at 426).

knowledge or experience, thus relying on a subjective test. The knowledge and experience of the specific director could therefore be less than the knowledge and experience expected of a person in his position.¹⁵³ Judge Romer said: “A director is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature to be performed at periodic board meetings and committees of the board on which he serves.”¹⁵⁴

The Insolvency Act of 1986¹⁵⁵ and the Company Directors Disqualification Act of 1986 provide for the disqualifications of directors and their possible personal liability. The test to determine whether a director applied the necessary standard of care and skill when managing a company has become more stringent and is now based on the test formulated in section 214 of the Insolvency Act of 1986. Section 214 states that any director or shadow director of a company who has gone into insolvent liquidation, some time before the winding-up of the company, can be liable for a contribution to the companies’ assets if that person knew or ought to have concluded that there was no reasonable prospect that the company could avoid going into insolvent liquidation. A disqualification order may also be awarded.¹⁵⁶ In order to determine liability, the court will apply a test with objective and subjective elements. The director’s behaviour will therefore also be tested against the standard that may reasonably be expected of a reasonable director in his position.

In *Norman v Theodore Goddard*¹⁵⁷ the court stated that the care a director of a company owes to the company when carrying out his functions is the care that may reasonably be expected of a person carrying out those functions. The court therefore applied a test with both an objective and a subjective element. Furthermore, in the

¹⁵³ At 428. See also Mayson et al. *Company Law* 454–455; Birds et al. *Boyle & Birds’ Company Law*. The *City Equitable* decision was affirmed in *Dorchester Finance Co Ltd v Stebbing* at 498. In the *Dorchester* case the failure to participate in activities of the company and the subsequent failure to discover defaults of the managing director on the part of the directors in question were held to be negligent.

¹⁵⁴ At 429.

¹⁵⁵ Section 214.

¹⁵⁶ The Company Directors Disqualification Act of 1986 s 10.

¹⁵⁷ [1991] BCLC 1028 (CD).

decision of *Re D' Jan of London Ltd*¹⁵⁸ it was stated that section 214 of the Insolvency Act of 1986 correctly sets out the common law duty of care of a director.¹⁵⁹

*Re Barings plc*¹⁶⁰ is an important English decision on the duty of care and skill. This case concerned disqualification orders sought against three of the company's former directors. A single trader carried out unauthorised activities in Singapore, which resulted in major losses to the company. The integrity or honesty of the former directors was not in question, but rather the way in which they managed the company and especially the activities of this trader. The court held that the directors did not comply with the objective standard appropriate of directors with their status and experience. Judge Parker held that "[d]irectors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors".¹⁶¹ He, furthermore, stated that although directors may delegate some of their functions to those below them in the management chain, they still have a duty to supervise the discharge of the delegated functions. The evaluation of the proper exercise of this discretion to delegate will depend on the facts of each case.

The section 214 test therefore goes further than the test formulated in the *Re City Equitable* decision, referred to above, which only relied on the specific director's knowledge and experience.¹⁶²

¹⁵⁸ (1994) 1 BCLC 561. In this case a director signed an insurance proposal form without paying attention to its contents and was held negligent. In *Re Westlowe Storage and Distribution Ltd* [2000] BCC 851 a director was also found to be negligent as he did not ensure that the company benefited properly from transactions it concluded. It was that director's responsibility to ensure that a proper accounting system was in place. See also Mayson et al. *Company Law* 454–455; Birds et al. *Boyle & Birds' Company Law* 528.

¹⁵⁹ This duty is not discussed in detail in this thesis. It therefore suffices to state that the Companies Act of 2006 provides for this duty in s 174 (duty of reasonable care, skill and diligence). This duty is more objectively formulated in the Companies Act of 2006, similar to s 214 of the Insolvency Act of 1986. See also ch 4 par 3.3 where the position on this duty in Australia is discussed.

¹⁶⁰ (1999) 1 BCLC 433. This decision is discussed in Sealy *Cases and Materials* 332.

¹⁶¹ At 536–537.

¹⁶² Accepted by Knox J in *Re Produce Marketing Consortium Ltd (No 2)* [1989] BCLC 520 (CD).

4 THE STAKEHOLDER DEBATE: CORPORATE GOVERNANCE CODES, THE COMPANY LAW REVIEW PROCESS AND THE COMPANIES ACT OF 2006

Even before the company law review, a number of corporate governance codes dealt with the issue of in whose interests directors should manage a company. In the following section some background is provided on the *Cadbury*, *Greenbury* and *Hampel Reports* to determine the viewpoints of the various committees on the protection of stakeholders. Against the background of these reports, the recent company law review process of the United Kingdom is also evaluated and the various documents drafted during the review process are discussed.¹⁶³ A brief overview of the consultation documents is provided, but the emphasis is on the arguments for and against stakeholder protection and the codification of directors' duties. Lastly, the Companies Act of 2006 is referred to, focusing on section 172(1) and the exhaustive code of directors' duties. It is important to refer to the corporate governance codes and specifically the consultation documents of the Steering Group during the company law review in order to understand the Companies Act of 2006 properly. There may be uncertainties as to how certain provisions of the new Act should be interpreted, especially in respect of the duties of directors. It is therefore necessary to refer back to previous sources, such as the consultation documents of the Steering Group to understand, for example, why certain duties are included and others not.¹⁶⁴

4.1 The Cadbury, Greenbury and Hampel Reports

It is necessary to refer briefly to the *Cadbury*, *Greenbury* and *Hampel Reports* as they provide a broad background on corporate governance, its definition and principles of good governance.¹⁶⁵ Firstly, it is important to refer to these reports concerning the

¹⁶³ The review dealt with the main components of company law, but excluded insolvency law and financial services. See Goddard "Modernising Company Law" 403.

¹⁶⁴ See a document on directors' duties in terms of the Companies Act of 2006 drafted by Ben Quiney, who practices commercial law at the Crown Office Chambers in London (hereafter Quiney *Directors' Duties*).

¹⁶⁵ Goddard "Modernising Company Law" 403 holds that the company law reform was done against the background of the *Cadbury*, *Greenbury* and *Hampel Reports*. See also Dignam "Lamenting Reform?" on the *Cadbury*, *Greenbury* and *Hampel Reports* 286–288.

protection of stakeholders. It will, however, be seen from the discussion below that these reports did not deal with stakeholders extensively. The *Cadbury and Greenbury Reports* had a focused application, but the *Hampel Report* was wider and dealt with various issues of corporate governance.¹⁶⁶ Secondly, and more importantly, these codes are of a self-regulatory nature and contain important guidelines concerning best practices in a company. In chapter 2 a theory was proposed on directors' duties and the protection of stakeholders. It was indicated that directors need to consider the interests of stakeholders in certain instances. In order to consider the interests of stakeholders sufficiently, directors need to have knowledge of the protection that stakeholders receive in other legislation. It has been suggested that codes of good practice can play an important role in this regard by providing directors with guidelines on how to interpret their duties.¹⁶⁷

4.1.1 Background on the Reports

Corporate governance had become prominent in the 1990s with the *Cadbury, Greenbury* and *Hampel Reports*.¹⁶⁸ These reports are each named after the chair of each committee. In response to a number of financial scandals and the fear of low standards of corporate governance in the United Kingdom the Cadbury and Greenbury Committees were formed.¹⁶⁹ It was stressed by these committees that the

¹⁶⁶ See ch 6 par 4.1 where it is indicated that *King II* was much wider in its application than the *Cadbury Report*.

¹⁶⁷ The GC100 has also proposed that codes of good practice guidelines should be developed to explain to directors how they should comply with s 172(1) of the Companies Act of 2006. In this way directors will be clearer on how to comply with their new duties, potential liability of companies will be reduced, the administrative burden will be minimised and it will demonstrate to stakeholders that companies are taking the new duties seriously.

¹⁶⁸ The *Report of the Committee on the Financial Aspects of Corporate Governance* chaired by Sir Adrian Cadbury 1992 (hereafter the *Cadbury Report*); *Directors' Remuneration Report: Report of a Study Group* chaired by Sir Richard Greenbury 1995 (hereafter the *Greenbury Report*); *Report of the Committee on Corporate Governance Final Report* 1998 (hereafter the *Hampel Report*). See Dine & Koutsias *Company Law* 187–188 referring to the *Cadbury, Hampel* and *Combined Code* initiatives. See also Mayson et al. *Company Law* 498 on these reports. Smerdon *A Practical Guide to Corporate Governance* 2–4 discusses the historical evolution of contemporary United Kingdom corporate governance and refers to the *Cadbury, Greenbury* and *Hampel Reports*. See further Cheffins "Current Trends in Corporate Governance" 5–42 on the *Cadbury, Greenbury* and *Hampel Reports*. It is held by Cheffins that these reports are self-regulatory in nature. It is, furthermore, stated that these reports did not pay much attention to the stakeholder debate. The committees did, however, equate the interests of "the company" with those of the shareholders collectively.

¹⁶⁹ For instance, failures such as Polly Peck (Polly Peck International was a rag trade textile company) and the Maxwell empire (Maxwell Communication Corporation plc (MCC) was formerly one of the

board of directors can act as a corrective mechanism when corporate executives are not sufficiently accountable for their actions.¹⁷⁰

The accounting profession, the London Stock Exchange and the Financial Reporting Council sponsored the establishment of the Cadbury Committee. The two main reasons for this sponsorship were (1) a low level of confidence in the corporate financial reporting regime in the United Kingdom and (2) fears that accounting shortcomings were undermining the effectiveness of companies' internal controls.¹⁷¹ The *Cadbury Report* mainly deals with financial accountability, and specifically the responsibilities of directors and their relationships with auditors.¹⁷² These standards of corporate governance are set out in a *Combined Code of Best Practices*,¹⁷³ published in December 1992. In Britain the majority of companies were incorporated under the Companies Act of 1985. This Act has now been repealed by the Companies Act of 2006. The Act of 1985 distinguished between public and private companies. A listed company had to comply with the *Listing Rules* of the London Stock Exchange.¹⁷⁴ All registered listed companies in the United Kingdom must comply with the 1992 Code. Other companies are also encouraged to meet its requirements.

world's ten largest media groups, with interests in information services and electronic school, college and professional language instruction and publishing. Robert Maxwell drowned in 1991 while yachting off the Canary Islands. After his death investigators discovered that Maxwell diverted hundred of millions of pounds from pension funds and other sources. The Maxwell empire was subsequently dissolved and sold off in the following year. See Youngusband "Corporate Governance in the United Kingdom" 276. See Belcher "Compliance with the Cadbury Code" 11–17 for an outline of the *Cadbury Report*; Cheffins "Current Trends in Corporate Governance" 5 for a discussion of the *Cadbury*, *Greenbury* and *Hampel Reports*. See also Dine & Koutsias *Company Law* 187.

¹⁷⁰ Cheffins "Current Trends in Corporate Governance" 10.

¹⁷¹ Cheffins "Current Trends in Corporate Governance" 12.

¹⁷² See Du Plessis "Corporate Governance" 81–90 who discusses the main features of the *Cadbury Report*. See also Villiers "Draft Report by the Cadbury Committee" 214 who confirms that the *Code of Best Practice* issued in terms of the *Cadbury Report* is self-regulatory.

¹⁷³ The code is part of the *Cadbury Report* available at <http://www.ecgi.org/codes/documents/cadbury.pdf> (accessed 4 July 2007) (hereafter the 1992 Code).

¹⁷⁴ Cheffins "Current Trends in Corporate Governance" 9.

The *Listing Rules* require that listed companies should state in their annual reports whether or not they complied with the rules during the period under review.¹⁷⁵

The *Cadbury Report* deals with issues relating to the remuneration of directors, and makes recommendations relating to disclosure and the establishment of a remuneration committee. Despite this, there was still concern regarding the huge remuneration packages of directors and departing directors. In January 1995 the Greenbury Committee was established as a discussion group on the remuneration of directors. The report of the committee was issued in July 1995. A *Code of Best Practice* was published simultaneously.¹⁷⁶

In November 1995 the Hampel Committee was established to review the recommendations of the Cadbury and Greenbury Committees.¹⁷⁷ The brief of the Hampel Committee covered all issues relating to corporate governance, and was therefore not as restricted as those of the Cadbury and Greenbury Committees. The remit of the committee was to review the *Cadbury Code* and its implementation and to ensure that the original purpose is being achieved. The commissioners were also asked to pursue any relevant matters arising from the *Greenbury Report*. But they also had an additional task, namely to look afresh at the roles of directors, shareholders and auditors in corporate governance. In January 1998 the Hampel Committee issued its *Final Report*.¹⁷⁸

On 25 June 1998 the London Stock Exchange published the *Code of Best Practices* (the *Combined Code*), which resulted from the work done by the Hampel

¹⁷⁵ See Gregory “Overview of Corporate Governance” referring to the *Cadbury Report* and the attempt to design corporate governance guidelines and a code of “best practice”.

¹⁷⁶ The code is part of the *Greenbury Report* available at http://www.ecgi.org/codes/code.php?code_id=131 (accessed 4 July 2007) (hereafter the *1995 Code*).

¹⁷⁷ See Riley “The Final Report of the Hampel Committee” on the *Hampel Report*.

¹⁷⁸ See Younghusband “Corporate Governance in the United Kingdom” 275–280 relating to the *Cadbury*, *Greenbury* and *Hampel Reports*. See also Sheikh “Introduction to the Corporate Governance Themed Issues” 267–274; Dignam “Exporting Corporate Governance” 70–76; Barnard “The Hampel Committee Report” 110–115.

Committee.¹⁷⁹ In July 2003 it was replaced with a new *Combined Code*.¹⁸⁰ The 2003 *Combined Code* derives from a review of the role and effectiveness of non-executive directors by Derek Higgs and a review of audit committees by Sir Robert Smith.¹⁸¹ The 2003 *Combined Code* is an appendix to the *Listing Rules*, but does not form part of it. The *Listing Rules* do not oblige companies to comply with the principles of the *Combined Code*, neither does the *Combined Code* have any statutory backing. Its objective is not to compel companies to comply with the *Combined Code*, but rather to ensure disclosure so that investors may have adequate information regarding corporate governance practices.¹⁸² The emphasis of the 2003 *Combined Code* is therefore on compliance with broad principles and, in addition, specific provisions contained in a *Code of Best Practice*.¹⁸³

The 2003 *Combined Code* is divided into two sections. Section 1 relates to companies listed in the United Kingdom and section 2 deals with institutional investors.¹⁸⁴ Section 1 consists of 14 principles of good governance. These principles are divided into four parts. The first part deals with directors. The overriding principle in this regard is that every listed company should have an effective board of directors who

¹⁷⁹ The *Combined Code* is annexed to the *Listing Rules* available at www.fsa.gov.uk/pubs (accessed 27 July 2006) (hereafter the 1998 *Combined Code*). See also Riley "The Final Report of the Hampel Committee" 179–180; Dignam "Exporting Corporate Governance" 70–76. Pettet "The Combined Code" 394–400 discusses the *Combined Code* of 1998. The *Combined Code* is based on compliance with broad principles of corporate governance. More specific provisions are contained in the *Code of Best Practice*. An analysis of the broad principles is provided by Pettet. He distinguishes between broad principles and code provisions. For example, there is the broad principle that every company should be headed by an effective board. The code provision on this board principle is that an effective board should include non-executive directors.

¹⁸⁰ Available at www.fsa.gov.uk/pubs (accessed 27 July 2006) (hereafter the 2003 *Combined Code*).

¹⁸¹ See *Review of the Role and Effectiveness of Non-Executive Directors* by Derek Higgs (January 2003) available at www.aar.com.au (accessed 27 July 2006) (hereafter the *Higgs Report*); *Audit Committees Combined Code Guidance by Sir Robert Smith* (January 2003) available at <http://www.football-research.org/docs/smithreport-30-01-03.pdf> (accessed 5 July 2007).

¹⁸² Belcher "Compliance with the Cadbury Code" 11–17; Cheffins "Current Trends in Corporate Governance" 26. Belcher conducted a small scale study on whether or not companies comply with the listing requirements. She concluded that compliance with the code was effective. This study concerned the *Cadbury Report* and their *Code of Best Practices* (1992 Code).

¹⁸³ The Hampel Committee strongly disapproved of box-ticking. Box-ticking concerns complying with the letter of the law, but not with the substance. See Pettet "The Combined Code" 394–400 for a detailed discussion of the 2003 *Combined Code*.

¹⁸⁴ Sections E1–E2 of the 2003 *Combined Code*.

should lead and control the company. The board should also consist of a balance of executive and non-executive directors. The board should be provided with relevant information to make decisions in a timely manner. There should be a formal and transparent procedure relating to the appointment of directors.¹⁸⁵ Part 2 concerns directors' levels of remuneration and provides that remuneration should be of such a nature that it attracts directors to manage a company successfully. A portion of the remuneration should be based on corporate and individual performance.¹⁸⁶ Part 3 relates to relations with shareholders. Greater shareholder activism is required. Boards should use the annual general meeting, for instance, to communicate with private investors and to encourage their participation.¹⁸⁷ Part 4 deals with accountability of directors and auditing requirements. The board should present a balanced and clear assessment of the position of the company and its prospects.¹⁸⁸

Section 2 concerns institutional shareholders. Dialogue between institutional investors and managers, and evaluating governance disclosures by taking all relevant factors into account are discussed in section 2. It is also stated that institutional investors should make use of their votes in a responsible manner. This section is important as it provides recommendations on how institutional investors can be more active in monitoring directors' actions. This falls beyond the ambit of this thesis and section 2 is therefore not discussed further.

In December 2006 the *2003 Combined Code* was updated. The Financial Reporting Council is responsible for updating the *Combined Code* on a regular basis. This 2006 code also has various sections with a main principle, supporting principles and code provisions. The layout is similar to the *2003 Combined Code* and not much has changed.

¹⁸⁵ Sections A1–A7 of the *2003 Combined Code*. See also Pettet “The Combined Code” 395–396.

¹⁸⁶ Sections B1–B2 of the *2003 Combined Code*.

¹⁸⁷ Sections D1–D2 of the *2003 Combined Code*.

¹⁸⁸ Sections C1–C3 of the *2003 Combined Code*. See Barnard “The Hampel Committee Report” 110–115 regarding the *Hampel Report*.

4.1.2 The Stakeholder Debate

The *Cadbury*, *Greenbury* and *Hampel Reports* confirm that there is no universal definition of ‘corporate governance’. Generally, corporate governance concerns directors’ duties to a company with board responsibility and accountability as important elements. As stated above, directors’ duties were traditionally owed to the shareholders,¹⁸⁹ and profit maximisation was directors’ ultimate goal when they managed a company.

The *Cadbury* and *Greenbury Reports* did not specifically deal with the issues of stakeholder protection and in whose interests directors should manage a company.¹⁹⁰

The committees equated a company’s interests with those of its shareholders and they based their recommendations on this viewpoint.¹⁹¹ They therefore favoured the traditional stance and they missed an ideal opportunity to discuss this issue. Fortunately, it was discussed in detail during the company law review process launched in 1998.¹⁹² The policy documents drafted during the review process are discussed in detail later in this chapter.¹⁹³

It was indicated above that the Hampel Committee dealt with corporate governance in a more general sense than the Cadbury and Greenbury Committees. The Hampel Committee says the following on the stakeholder debate:

Our next step was to consider the aims of those who direct and control companies. The single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders’ investment . . .

A company must develop relationships relevant to its success. These will depend on the nature of the company’s business; but they will include

¹⁸⁹ Paragraph 3.1.1 above.

¹⁹⁰ They did not, for instance, consider employee participation on board level. See Du Plessis “Corporate Governance” 87.

¹⁹¹ Cheffins “Current Trends in Corporate Governance” 29.

¹⁹² Paragraph 4.2.1 below. Cheffins “Current Trends in Corporate Governance” 29.

¹⁹³ Paragraph 4.2.3 below.

those with employees, customers, suppliers, credit providers, local communities and governments.

This recognises that the directors' relationship with the shareholders is different in kind from [sic] their relationship with the other stakeholder interests. The shareholders elect the directors. As the CBI put it in their evidence to us, the directors as a board are responsible *for relations with stakeholders; but they are accountable to the shareholders*. This is not simply a technical point. From a practical point of view to redefine the directors' responsibilities in terms of the stakeholders would mean identifying all the various stakeholder groups; and deciding the nature and extent of the directors' responsibility to each. The result would be that the directors were not effectively accountable to anyone since there would be no clear yardstick for judging their performance. This is a recipe neither for good governance nor for corporate success.¹⁹⁴ [Emphasis added]

From this it can be deduced that the *Hampel Report* is in favour of other interest groups being taken into account, but only if shareholders will ultimately benefit. A company must develop relationships relevant to its success and these relationships will include those with employees, creditors, customers and suppliers. The stakeholders that directors will consider will vary depending on the business of the company. The Hampel Committee supports the view that the overall duty of directors is the welfare of shareholders, specifically profit maximisation. The committee states that it would be difficult to identify all stakeholder groups and to determine the nature and extent of the duties relating to each group. Ultimately, directors would be accountable to no one, because being accountable to "everyone" can result in no accountability.¹⁹⁵

4.1.3 Self-Regulation Versus Codification

The objectives of the codes of best practices referred to above were not to prescribe any specific corporate behaviour in detail. Rather, the codes are intended to be self-regulatory in nature. They are based on a voluntary approach and not on compulsion through legislation.¹⁹⁶ The aim of the codes was to raise the standards of corporate

¹⁹⁴ Paragraphs 1.16–1.17 of the *Hampel Report*.

¹⁹⁵ Sheikh "Introduction to Corporate Governance Themed Issues" 268–269.

¹⁹⁶ Sheikh "Introduction to Corporate Governance Themed Issues" 272.

governance, financial reporting and auditing.¹⁹⁷ The *Cadbury Report* states: “We believe our approach, based on compliance with a voluntary code coupled with disclosure will prove more effective than a statutory code. It is directed at establishing best practice, and at allowing some flexibility in implementation.”¹⁹⁸ The Greenbury Committee had the same idea, stating in their report that “[t]he way forward as we see it lies not in statutory controls, which would be at best unnecessary and at worst harmful, but in action to strengthen accountability and encourage enhanced performance”.¹⁹⁹ The Hampel Committee refers to the danger of box-ticking in their report. Box-ticking refers to the situation where corporate governance boxes are ticked, indicating that there was compliance with a specific aspect. There must be compliance with the rule and not just with the form.

As stated before, the United Kingdom Companies Act of 2006 now contains an exhaustive codification of directors’ duties.²⁰⁰ Directors’ duties are therefore no longer self-regulated in terms of United Kingdom company law.²⁰¹ It is, however, important to note that to have a code of directors’ duties (whether comprehensive or partial) does not imply that there will no longer be self-regulatory codes of best practice. The exhaustive code in the Act concerns the contents of directors’ duties. Codes of best practice can (and must) still provide directors with guidance concerning the exercise of their duties and create high standards of corporate governance.²⁰²

The code of directors’ duties as formulated in the Companies Act of 2006 is discussed in detail in paragraph 4.3 below.

¹⁹⁷ Esser & Coetzee “Codification of Directors’ Duties” 27–28; Belcher “Compliance with the Cadbury Code” 11–17; Cheffins “Current Trends in Corporate Governance” 21.

¹⁹⁸ Paragraph 1.10 of the *Cadbury Report*.

¹⁹⁹ Paragraph 1.13 of the *Greenbury Report*.

²⁰⁰ The South African Bill only provides for a partial codification of directors’ duties.

²⁰¹ See ch 6 par 5 relating to the position in South Africa.

²⁰² See, for example, the suggestion in ch 2 par 5.2 below that directors should receive guidance on the protection of stakeholders in codes of best practice. These codes can provide information on the protection that stakeholders receive in other, separate legislation.

4.2 The United Kingdom Company Law Review Process

4.2.1 Historical Overview

By the middle of 1997 it had become clear that company law in the United Kingdom was no longer in line with modern business practices. It had been reviewed at approximately 20 year intervals.²⁰³ In 1962 the Jenkins Commission was established, but the recommendations of this committee were never really implemented.²⁰⁴ After 1972 the legislative programme was dominated by the need to incorporate European Community harmonising directives.²⁰⁵ The 1980s were dominated by the criminalisation of insider dealings. Therefore, in short, by 1997 the company law of the United Kingdom had many outdated provisions. A large part of company law was also to be found in case law. The Department of Trade and Industry drafted a series of protocols during the 1990s relating to the possible consultation on the review of company law, stating that there was a need for a simpler system of company law.²⁰⁶ In 1991 a paper of the Law Society supported a need for company law reform. This paper proposed the establishment of a company law commission,²⁰⁷ but the commission was not able to deal adequately and quickly with all the problems of company law reform.²⁰⁸ In 1998 the Secretary of State for Trade and Industry announced a three-year fundamental review of core company law. This review was led by an independent steering group. Their aim was to develop a simple, modern, efficient and cost-effective framework to carry out business activity in Britain for the

²⁰³ Reform had taken place in a typically piecemeal approach. See the *Loreburn* (1907), *Greene* (1928), *Cohen* (1945), *Jenkins* (1963) *Reports*. See Goddard “Modernising Company Law” 403.

²⁰⁴ Freedman “Reforming Company law” 209 argues that the Jenkins Commission did not stimulate or excite and was too cautious by referring to Pennington “Reports of Committees” 703–710. She also refers to Gower who said that the committee had broken down and that the taking of oral evidence was a waste of time.

²⁰⁵ Paragraph 2.4 above.

²⁰⁶ As stated above, in the 1990s the *Cadbury*, *Greenbury* and *Hampel Reports* were issued.

²⁰⁷ *The Reform of Company Law*, Law Society Legal Practice Directorate, No 255, July 1991 Law Society (1991) (hereafter the *Law Society Company Reform*). See Rickford “A History of the Company Law Review” 3–37 for a detailed discussion of the history of company law reform in the United Kingdom.

²⁰⁸ Rickford “A History of the Company Law Review” 3–9.

twenty-first century.²⁰⁹ The Steering Group's point of reference amounted to the creation of a "framework of company law which promoted the competitiveness of British companies, struck the proper balance between the interests of those concerned with companies, in the context of straightforward, cost-effective and fair regulation, and promoted consistency, predictability and transparency in the law".²¹⁰

In the course of the review process, various consultation documents were drafted. Some of the reasoning for the final recommendations is therefore found in earlier documents.²¹¹ The Steering Group adopted three core principles when reviewing the United Kingdom Companies Act, namely to apply a "think small first" approach; that the regime of corporate governance should be improved; and that a flexible and institutional structure for rule-making and enforcement should be set up.²¹² The Steering Group also had regard to the following general principles of company law reform: company law reform should succeed on a technical level, reform should satisfy economic criteria and company law should also succeed at a philosophical level. The Steering Group also listed a number of guiding principles. Firstly, company law should be primarily enabling and efficient.²¹³ Secondly, company law should enhance international competitiveness.²¹⁴ Thirdly, entrepreneurial freedom

²⁰⁹ See www.dti.gov.uk/cld/review (accessed 20 June 2006). See also Attenborough "The Company Law Reform Bill" 162–169 where he discusses the company law reform of the United Kingdom as undertaken by the Steering Group.

²¹⁰ *Final Report* n4 at par 1. 3 as referred to in Rickford "A History of the Company Law Review" 10.

²¹¹ This thesis will focus on *Modern Company Law for a Competitive Economy* (March 1998) available at <http://www.lens-library.com/info/DTI0399FINAL.html>; (the *Strategic Framework*); *Developing the Framework*; *Completing the Structure*; the *Final Report*; the *White Paper of 2005*. See also *Modern Company Law for a Competitive Economy: Reforming the Law concerning Overseas Companies* (October 1999); *Company Formation and Capital Maintenance* (October 1999); *Company General Meetings and Shareholder Communication* (October 1999); *Capital Maintenance Other Issues* (June 2000); *Registration of Company Charges* (October 2000); *Trading Disclosures* (October 2000). All these documents are available at www.dti.gov.uk/bbf/co-act-2006 (accessed 25 June 2006).

²¹² See *Modern Company Law for a Competitive Economy* (March 1998); Arden "Reforming the Companies Acts" 581–582; Alcock et al. *Companies Act 2006* 3–11 on the company law review Steering Group.

²¹³ Company law should provide the needs for those involved in businesses to manage their affairs in a way in which they believe will lead to success and productive activity, see the *Final Report* at par 1.26 and Goddard "Modernising Company Law" 406.

²¹⁴ Goddard "Modernising Company Law" 408.

should be coupled with transparency²¹⁵ and regulation must be justified.²¹⁶ Company law must therefore be accessible, the language must be simple and clear, and the common law should be codified.²¹⁷ Fourthly, company law should take account of the modern asset mix and should be suitable for all the different kinds of companies.²¹⁸

The Steering Group made various recommendations.²¹⁹ This thesis focuses primarily on the recommendations relating to corporate governance issues, especially the protection of stakeholders and directors' duties.²²⁰

4.2.2 The Different Phases in the Review Process

It was indicated above that the United Kingdom engaged in a company law review process in 1998. The different phases of this process, as reflected in the various company policy documents, are briefly discussed below.²²¹ A more detailed discussion follows on the views expressed in these company law review documents on the issue of the codification of directors' duties, as well as the question of in

²¹⁵ The basic framework of company law should provide as much as possible freedom to the participants, but combined with the necessary transparency to exercise this freedom, see the *Final Report* par 1.15; Goddard "Modernising Company Law" 409.

²¹⁶ Deregulation and simplification is important, especially concerning smaller companies. Goddard "Modernising Company Law" 409.

²¹⁷ Compliance is dependent on the way in which the law is understood. This relates to the statutory statement of directors' duties. See Goddard "Modernising Company Law" 409.

²¹⁸ Arden "Reforming the Companies Acts" 583. See generally on the company law reform process: Goddard "Modernising Company Law" 402; 404–405 with regard to a brief background on the company law reform process. The stakeholder debate is specifically focused on referring to the enlightened shareholder value approach.

²¹⁹ The Steering Group made certain recommendations with regard to private companies. Companies differ from one another, especially concerning size. It was therefore important to establish whether the company law review process was applicable to all companies. See Arden "Reforming the Companies Acts" 583–586 regarding the recommendations of the Steering Group relating to private companies. The Steering Group also made recommendations concerning a new institutional framework. They recommended that there should be a number of bodies responsible for enforcing and updating company law. See Arden "Reforming the Companies Acts" 583–597; the *Final Report* at pars 3.56–3.66; 5.13–5.101.

²²⁰ The *Final Report* at pars 3.7; 7.33–7.51; 7.5–7.16.

²²¹ As stated before, various policy documents were issued during the company law review process. A brief overview is provided, but only the chapters dealing with the question of in whose interests directors should manage the company and the codification of directors' duties are discussed in detail.

whose interests directors should exercise their duties when they manage a company.²²²

4.2.2.1 *The Strategic Framework*

The Steering Group held their first meeting in June 1998 to decide on a basic philosophy and a plan concerning the review process. In February 1999 the outcomes of these consultations were reflected in a document entitled the *Strategic Framework*. A number of key issues to be addressed during the consultations and the preferred way forward were discussed in this document. These issues included the scope of company law, the needs of small and closely held companies, company formation, capital maintenance, regulation and boundaries of the law, international issues, and information and communications technology.²²³ These selected key issues were discussed in different working groups.²²⁴

Chapter 5.1 of the *Strategic Framework* is important for the purposes of this thesis.²²⁵

Chapter 5.1 analyses the interests that company law should serve, stating that

²²² It was clear (after the Department of Trade and Industry had launched its company law reform process by issuing a consultation paper) that the stakeholder issue was at the heart of the review, the issue as to whether or not directors' duties should be codified also attracted many comments. See *Modern Company Law for a Competitive Economy* (March 1998) at par 3.7; *Strategic Framework* at p 3. See also Omar "The Company We Keep" 223–225, in which he refers to the company law review process in the context of the formation of a company.

²²³ See pp 33–114 of the *Strategic Framework*. See also Rickford "A History of the Company Law Review" 11–20 for a detailed discussion of the *Strategic Framework*.

²²⁴ The seven issues discussed in ch 5 of the *Strategic Framework* were allocated to three different working groups. Membership of the working groups was decided on by the Steering Group, in consultation with the Department of Trade and Industry. Each working group was led by a member from the Steering Group. The Steering Group met monthly where the minutes from the various working groups were discussed.

²²⁵ Chapter 2 of the *Strategic Framework* sets out the overall approach to be taken. The objective of the reform process is to have a modern law supporting a competitive economy. See pp 8–20 of the *Strategic Framework*. A "think small first" approach was taken. Chapter 3 (pp 21–23 of the *Strategic Framework*) relates to the European Union and human rights and chapter 4 (pp 24–32 of the *Strategic Framework*) briefly reviews current trends in other jurisdictions. Chapter 5.2 addresses the needs of small and closely-held companies indicating that they are not well served in terms of the Companies Act of 1985 (see pp 56–69 of the *Strategic Framework*). It was recommended that small- and medium-sized companies should be retained in the current framework, but the framework should be restructured to meet their needs. Chapter 5.3 and 5.4 concern company formation and capital maintenance. The introduction of no par value shares and to remove the need for court approval of capital reductions are some of the proposals to simplify the law (see pp 70–91 of the *Strategic Framework*). Chapter 5.5 presents boundaries between various regulatory and enforcement jurisdictions. There is, for example, a proposal to move in the direction of non-statutory regulation, away from criminal and civil sanctions (see pp 92–95 of the *Strategic Framework*). Chapter 5.6

directors should serve the interests of a wider variety of groups than just the shareholders. In this regard a distinction is drawn between the enlightened shareholder value and the pluralist approaches.²²⁶ This aspect of the review process is discussed in more detail below.²²⁷

4.2.2.2 *Developing the Framework*

This document is similar to the *Strategic Framework* consultation document and draws together the work done by the second phase working groups, which were established to deal with the following issues: small companies, the scope of company law, the role of directors, the role of shareholders, technical issues on shares, accounting and reporting, and registration of information by companies. It was published in March 2000.

Chapters 2 and 3 are important for purposes of this thesis.²²⁸ Chapter 2 provides a background and overview,²²⁹ followed by chapter 3 which deals with the duties of directors and company officers.²³⁰ Reference is made to the stakeholder debate in

examines the current international attractiveness of United Kingdom company law (see pages 96–106 of the *Strategic Framework*) and chapter 5.7 relates to information and communications technology, referring to company meetings and communications with members (see pp 107–114 of the *Strategic Framework*). Chapter 6 describes the key issues relating to financial reporting. These include the form and content of accounts; the role of accounting standards and international standards; exemptions for small- and medium-sized companies; and the report of a director. Chapter 7 deals with the work done by the English and Scottish law commissions (see pp 115–125, 126–133 of the *Strategic Framework*). In chapter 8 options for the form or shape of new legislation and methods of keeping the law up to date are discussed. Chapter 9 describes the way forward and what the next stage should entail (see pp 134–148 of the *Strategic Framework*).

²²⁶ Pages 33–55 of the *Strategic Framework*. See ch 2 par 5.1 for a discussion of these approaches.

²²⁷ See par 4.2.3 below.

²²⁸ Chapter 1 provides an introduction and some general background. Part 1 of this document deals with governance issues. These governance issues are discussed in chapters 2–5. Chapter 4 deals with shares and shareholders. Chapter 5 deals with reporting and auditing (see pp 7–200 of *Developing the Framework*). Part 2 relates to small and private companies and alternative vehicles (see chapters 6–10 and pp 219–369 of *Developing the Framework*). Issues such as reports and accounts for small companies and a proposed simplification for private companies are discussed.

²²⁹ In this chapter the scope of company law is discussed.

²³⁰ A legislative statement of directors' duties is proposed.

chapter 2. Chapter 3 contains a legislative statement. These two chapters are discussed in more detail below.²³¹

4.2.2.3 *Completing the Structure*

This was the last consultation document issued before the *Final Report* was issued in May 2001.²³² This document mainly takes the issues discussed in *Developing the Framework* forward. Chapter 3 deals with corporate governance issues, specifically relating to the scope of company law, directors' duties and the Operating and Financial Review.²³³ For purposes of this thesis, the issues in chapter 3 are important and are discussed below.²³⁴

4.2.2.4 *The White Papers of 2002 and 2005*

In July 2002 the government released its first response to the above-mentioned company law review process in the form of a White Paper.²³⁵ Most of the recommendations of the *Final Report* were accepted in the *White Paper of 2002*.²³⁶

²³¹ Paragraphs 4.2.3.2, 4.2.4.2.

²³² *Completing the Structure* was issued in November 2000.

²³³ The OFR. In *Completing the Structure* a new mandatory OFR is proposed. The OFR should be published by all public and very large private companies as part of their annual report. The directors should account for the performance and direction of the business, including a fair review of achievements and trends, and strategic direction. This is an important development concerning directors' duties as it requires of directors to report on the company, including the recognition of wider relationships by directors: see *Completing the Structure* par 3.2. Chapter 1 contains an introduction and some background, confirming that this is the third consultation document by the Steering Group. Chapter 2 concerns small- and medium-sized companies. Chapter 4 concerns unlisted and smaller quoted companies, directors and the market in corporate control. Chapter 5 deals with shares and shareholders. Chapter 6 deals with reporting, accounting and audit. Chapter 7 deals with capital maintenance and chapter 8 with company registrations and the provision of information. Chapter 9 is concerned with alternative corporate vehicles and access to limited liability. Chapter 10 deals with company law and groups of companies²³³ and chapter 11 relates to reconstruction, mergers and jurisdictional migration. Chapter 12 provides for a regulatory and institutional framework for company law and chapter 13 deals with sanctions (see pp 169–338 of *Completing the Structure*).

²³⁴ Paragraphs 4.2.3.3, 4.2.4.3.

²³⁵ White Papers are issued by the government as statements of policy and often set out proposals for legislative changes, which may be debated before a Bill is introduced. Some White Papers may invite comments. On the 2005 *White Paper*, see Sheikh "Company Law Reform" 13–21; Howell "The Company White Paper" 203–210.

²³⁶ For example, they declined the proposal of the Steering Group for a statutory company law and reporting commission, as a way to keep company law up to date. The government said that there is no need for such a commission, because the Bill is drafted in such a way that future needs are being met (through flexible secondary legislation). See Edwin "White Paper and the Draft Companies Bill Published" 308.

The *White Paper of 2002* is divided into five parts, namely: (1) an introduction, (2) an outline of the government's policy, (3) notes on the draft clauses, (4) a regulatory impact assessment and (5) a conclusion relating to their viewpoints. A draft Companies Bill and a number of further questions for consultation were also part of the *White Paper of 2002*. The *White Paper of 2002* is of less importance in view of the fact that another White Paper was published in 2005.

In November 2005 the Company Law Reform Bill was introduced to Parliament. The *White Paper of 2005* sets out a range of measures relevant to the proposed Company Law Reform Bill. The contents of the *White Paper of 2005* were similar to the recommendations made by the Steering Group.²³⁷ Four objectives are crucial, when these measures are considered.²³⁸ The first objective relates to enhancing shareholder engagement and long-term investments. The second and third objectives concern better regulation and a “think small first” approach. Although the vast majority of companies in the United Kingdom are small companies, company law had been written with the larger company in mind. The Steering Group wanted to restore this balance and make the law easier for all to understand.²³⁹ In terms of the last objective, unnecessary burdens should be removed when incorporating a company.

This thesis focuses on the first objective, namely to enhance shareholder engagement and long-term investments. When discussing the first objective, the drafters refer to the enlightened shareholder value approach. They state that directors should manage a company for the benefit of the shareholders, ensuring that they are informed and involved in business decisions.²⁴⁰ Directors' decisions should be based on the long-term view of a company and not just on immediate returns. The Steering Group also refers to the codification of directors' duties in order to clarify their responsibilities

²³⁷ Page 9 of the 2005 *White Paper*.

²³⁸ Foreword of the 2005 *White Paper*.

²³⁹ Pages 5–6 of the 2005 *White Paper*. See also ch 4 of the 2005 *White Paper*.

²⁴⁰ Pages 33–55 of the *Strategic Framework; Completing the Structure* ch 3.

and to improve the law regulating their duties.²⁴¹ These two issues are discussed in detail below, and this *White Paper*, as well as the three other consultation documents referred to above, are considered.²⁴²

In 2006 the Company Law Reform Bill was published as the Companies Bill.²⁴³ The Bill completed the Commons Committee stage on 20 July 2006. The Bill amends and restates many of the provisions of the 1985 Companies Act. It also codifies certain provisions derived from case law.²⁴⁴ In November 2006 the Companies Act was published.²⁴⁵ Some of its provisions came into effect during 2006, 2007 and 2008. The remainder of the provisions will be effective by October 2009.²⁴⁶ The relevant aspects of this Act are discussed in detail later in this chapter.²⁴⁷

4.2.3 The Stakeholder Debate

The protection of stakeholders is one of the issues that received considerable attention during the company law review process. This issue refers to the question of whose interests company law should serve and the legal means by which it should do so.²⁴⁸ This matter is closely linked with the codification of directors' duties. The duty

²⁴¹ *Developing the Framework* pars 3.17–3.19; *Completing the Structure* par 3.3.

²⁴² Pages 5–6 of the 2005 *White Paper*.

²⁴³ Companies Bill 190 (hereafter the Companies Bill).

²⁴⁴ See www.publications.parliament.uk/pa/cm200506/cmbills/190 regarding the Companies Bill (accessed 20 August 2006). The Bill is divided into three volumes. Volume I contains clauses 1 to 482. Volume II contains clauses 483 to 1000. Volume III contains the remaining clauses and the Schedules. The structure of the Bill is as follows: Parts 1–7 deal with the fundamentals of what a company is, how it can be formed and what it is called, parts 8–12 deal with members/shareholders and the management of a company (the part on directors, part 10, is especially important for this thesis), parts 13 and 14 deal with company decision making, parts 15 and 16 deal with the safeguards for ensuring that the officers of a company are accountable to its members, parts 17–24 deal with the raising of capital, annual returns and takeovers, parts 25–33 deal with the regulatory framework, parts 34 and 35 deal with business names and statutory auditors, part 36 deals with transparency obligations and parts 37–40 with general matters.

²⁴⁵ The Act received royal assent on 8 November 2006. See Keay “Section 172(1)”; Linklater “Promoting Success” for a brief history of the different stages of the company law reform process.

²⁴⁶ See par 4.3.1 below for the exact dates.

²⁴⁷ Paragraph 4.3 below.

²⁴⁸ *Developing the Framework* ch 2 par 7. See Schall et al. “Promoting an Inclusive Approach” 304–306 on the approach followed by the Steering Group during the company law review.

of directors to act in the best interests of the company is addressed in the code of directors' duties. In this section the general viewpoints expressed in the various consultation documents on stakeholders and their interests are evaluated.

The Steering Group, "for ease of reference", referred to two basic approaches as far as company interests and the stakeholder debate are concerned, namely the so-called enlightened shareholder value approach and the pluralist approach.²⁴⁹ They summarised the two different approaches as follows:

A distinction is drawn between the enlightened shareholder value approach, which asserts that [productive relationships] can be achieved within present principles, but ensuring that directors pursue shareholders' interests in an enlightened and inclusive way, and the 'pluralistic' approach, which asserts that co-operative and productive relationships will only be optimised where directors are permitted (or required) to balance shareholders' interests with those of others committed to the company.²⁵⁰

It should be noted that the Steering Group acknowledged that what they called the enlightened shareholder value is often referred to in the literature as "enlightened self interest"²⁵¹ and that "current law is not widely recognised as embracing the enlightened shareholder value approach".²⁵² The Steering Group seems to strongly favour the so-called enlightened shareholder value approach.²⁵³

When perusing the consultation documents of the Steering Group drafted during the company law reform process, it may seem as if these two approaches are the only relevant approaches on the nature of companies. It is submitted that the Steering Group referred to these two approaches to emphasise two possibilities when considering the interests of stakeholders, namely shareholder primacy or the

²⁴⁹ See the *Strategic Framework* at p 37, par 5.1.11. These approaches are discussed in detail in ch 2 par 5.1 above. It has been stated that the enlightened shareholder value approach has a strong emphasis on shareholder primacy and the pluralist approach on the protection of stakeholders.

²⁵⁰ The *Strategic Framework* at p iv, par 5.

²⁵¹ The *Strategic Framework* at p 37, par 5.1.11, fn 27.

²⁵² The *Strategic Framework* at p vi, par 6.

²⁵³ The *Strategic Framework* at p 39, par 39; p 42, par 5.1.23; pp 43, par 5.1.25 ff.

protection of different stakeholders. The Steering Group did not provide an adequate theoretical background on the different theories of company law. It is a very broad field, as was seen from chapter 2 above, and it would have been an extensive exercise for the Steering Group to refer to all the different theories and the interpretations given to the theories by different commentators. Not only do the theories of the corporation and approaches to company law vary considerably, but there are also so many nuances and variations of the various theories and approaches to company law that it would be totally misleading if the impression is created that these theories and approaches boil down to a simple choice between an enlightened shareholder value approach and a pluralist approach. Many other labels could be used, such as “the constituency theory”, “the shareholder primacy theory”, “the associative theory”, and “the inclusive stakeholder theory” to explain different approaches to company law as far as directors’ duties are concerned.²⁵⁴ It is therefore important to keep in mind that these two approaches are not the only relevant ones. They are only referred to, to provide the two ends of the scale, namely shareholder primacy and stakeholder protection.²⁵⁵

²⁵⁴ Chapter 2 par 5.1 above. It should also be appreciated that the Steering Group defined the enlightened shareholder value approach and pluralist approach in such a way that they seem to be completely competing approaches. None of the variations of these approaches was analysed in the Discussion Papers, neither does it provide any in-depth discussion of the recent developments regarding perceptions of social and other responsibilities of large corporations. It also neglected to analyse the importance of the entity theory and the associated, but very important, legal principle that directors owe their duties towards “the company as a separate legal entity”. See Esser & Du Plessis “Stakeholder Protection” 351; Attenborough “The Company Law Reform Bill” 165 in this regard.

²⁵⁵ See Esser & Du Plessis “Stakeholder Protection” 351; Attenborough “The Company Law Reform Bill” 165 in this regard. See also McKenzie-Skene “Directors’ Duties to Creditors” 511–528 where she discusses the stakeholder debate and the codification of directors’ duties in the context of the consultation documents of the Steering Group. See further Keay “Enlightened Shareholder Value” where he refers to the company law reform of the Steering Group that started in 1998. He specifically refers to the stakeholder debate. He refers to the two approaches adopted by the Steering Group, namely the enlightened shareholder value and pluralist approaches (at 346–347). The enlightened shareholder value approach was favoured. Shareholders collectively should receive primacy when directors manage a company, but not with exclusive concern to short-term goals (at 361). He discusses the first and second *White Papers* (2002 and 2005). The government was in favour of a codification of directors’ duties. Lastly see Roach “The Legal Model of the Company” 98, who distinguishes between the enlightened shareholder value and pluralist approaches. He indicates that the Steering Group followed a shareholder approach, but not as strict as traditionally applied. Directors should also consider the interests of other stakeholders.

4.2.3.1 *The Strategic Framework*

Chapter 5.1 of the *Strategic Framework* deals with the protection of stakeholders. It confirms that the traditional position is that companies are formed and managed for the benefit of the shareholders, subject to safeguards for the benefit and protection of creditors.²⁵⁶ It was further stated that directors are obliged to manage a company “honestly, in their best judgment, for the benefit of the company. This traditionally means for the benefit of the shareholders as a whole.”²⁵⁷ Accounting and disclosure requirements also operate to protect creditors and the community as a whole.²⁵⁸ It is acknowledged that directors should, where appropriate, have regard to the need to ensure productive relationships with interested parties and to long-term interests. It is argued that it is necessary to protect the interests of those who are dependent on the company or those who made significant investments in the company or who carry real residual risks.²⁵⁹

A distinction is made between the enlightened shareholder value and pluralist approaches, as explained before. When opting for the enlightened shareholder value approach, the traditional company law does not have to change significantly as the ultimate objective of companies remains the same, namely profit maximisation for the shareholders.²⁶⁰ In the *Strategic Framework* it is, however, suggested that directors should adopt a broader and longer-term view of their role. This is referred to as an “inclusive approach”.²⁶¹ Should one opt for the pluralist approach, reform of company law will be necessary, because the interests of other stakeholders are also taken into consideration. For example, shareholders’ control over the company

²⁵⁶ The *Strategic Framework* par 5.1.4. See the following articles discussing the *Strategic Framework*: Rickford “A History of the Company Law Review” 11–20 (it is stated that the enlightened shareholder value approach was recognised as a “broadly correct statement of the law”) at 15; Goddard “Modernising Company Law” 404–409 (This paper examines the *White Paper* and the role that it ascribes to company law in general).

²⁵⁷ The *Strategic Framework* par 5.1.5.

²⁵⁸ The *Strategic Framework* par 5.1.4.

²⁵⁹ The *Strategic Framework* par 5.1.5 n 23.

²⁶⁰ The *Strategic Framework* par 5.1.12

²⁶¹ The *Strategic Framework* par 5.1.17.

through their determination of the composition of the board will have to be changed.²⁶² In the *Strategic Framework* the enlightened shareholder value approach is preferred, but it is stated that the traditional law does not embrace this approach in a satisfactory manner.²⁶³ It is noted that the issue of stakeholder protection will be discussed in more detail in subsequent consultation documents.

4.2.3.2 *Developing the Framework*

In *Developing the Framework* this issue of stakeholder protection is taken further in chapter 2 of the *Framework*. The Steering Group argues that the overall objective of wealth maximisation can best be achieved through an inclusive approach. In other words, directors need to have regard to all relationships that might have an impact on the short- and long-term consequences of the company, with a view to achieving success for the company's shareholders as a whole.²⁶⁴ The proposed way forward concerning the protection of stakeholders is then discussed. The Steering Group states that a statutory statement of directors' general duties will provide guidance to directors and articulate developments in case law.²⁶⁵ One of the duties in the code is that directors should achieve success of the company for the benefit of the shareholders collectively, by taking proper account of all relevant factors for that purpose.²⁶⁶ This includes a balance between short- and long-term considerations. Relationships with consumers, employees and suppliers, for instance, should also be sustained.²⁶⁷ Companies should therefore be managed in a way that maximises overall competitiveness, and wealth and welfare. This should not be done at the expense of turning companies into moral, political or economic arbiters.²⁶⁸ The key components of this duty of directors to promote the success of the company are

²⁶² The *Strategic Framework* par 5.1.13.

²⁶³ The *Strategic Framework* par 5.1.6.

²⁶⁴ Chapter 3 in *Developing the Framework*.

²⁶⁵ See *Developing the Framework* par 3.40. See also Rickford "A History of the Company Law Review" 20–27 where the enlightened shareholder value approach and a possible codification of directors' duties are discussed as considered by the Steering Group in *Developing the Framework*.

²⁶⁶ *Developing the Framework* par 2.19.

²⁶⁷ *Developing the Framework* par 2.19.

²⁶⁸ *Developing the Framework* par 2.21.

therefore the inclusive duty and broader accountability.²⁶⁹ Directors should have regard to the company's business and wider external relationships. Directors should act in the best interests of the shareholders collectively, but this can only be achieved when wider interests are also considered.²⁷⁰

Although the Steering Group states that directors should act in the best interests of the shareholders collectively, the reference to the so-called enlightened shareholder value approach is far less prominent. There is, in fact, just one reference to it in the main text of chapters 2–4.²⁷¹ The pluralist approach is mentioned on 21 occasions in chapters 2–4, but the main purpose of these references is to reject the approach rather than trying to explain it further or to emphasise variations of such an approach. The Steering Group rejected the pluralist approach as an approach that should be followed in defining directors' duties.²⁷²

4.2.3.3 *Completing the Structure*

In *Completing the Structure*, firm conclusions are adopted concerning the protection of stakeholders. It is confirmed that the pluralist approach will not be adopted. This decision is based mainly on the problems associated with the enforcement of directors' duties when a number of stakeholders are provided with direct protection.²⁷³ In chapter 3 of this Consultation Document, which deals with directors' duties, no reference is made to the so-called enlightened shareholder value approach. The pluralist approach is only mentioned once in the main text and only to observe that the Steering Group saw it as a key objection that the supporters of the pluralist approach did not suggest "a practical means of dealing with the crucial question of how such a duty could be enforced".²⁷⁴

²⁶⁹ *Developing the Framework* par 2.22.

²⁷⁰ *Developing the Framework* pars 2.19–2.26.

²⁷¹ *Developing the Framework* p 14, par 2.21.

²⁷² See in particular pars 3.1; 3.20ff in *Developing the Framework*. See Esser & Du Plessis "Stakeholder Protection" 351.

²⁷³ *Completing the Structure* par 3.5.

²⁷⁴ *Completing the Structure* par 3.5.

4.2.3.4 *The White Paper of 2005*

In the *White Paper of 2005* the enlightened shareholder value approach is referred to. The government agrees with the Steering Group in stating that directors should promote the success of the company for the benefit of its shareholders. This can, however, only be achieved by taking short-and long-term factors and stakeholders, such as employees, suppliers and customers, into account. The government therefore agrees that the enlightened shareholder value approach is the best one to follow as it drives long-term company performance, and maximises competitiveness and wealth.²⁷⁵

This approach is reflected in the statement of directors' duties, discussed in the next section.

4.2.4 Self-Regulation Versus Codification

The codification of directors' duties was one of the main aspects considered by the Steering Group during their review process.²⁷⁶ The viewpoints of the Steering Group as reflected in the various policy documents are considered in this discussion.²⁷⁷

4.2.4.1 *The Strategic Framework*

The Steering Group agreed that directors' duties should be codified.²⁷⁸ In the first of the three consultation documents, the *Strategic Framework*, the Consultation

²⁷⁵ In *Completing the Framework* par 3.12 it was stated that the new statement on directors' duties should state that "the duties operate subject to other provisions in the Act and to the supervening obligations to have regard to the interests of creditors when the company is insolvent or threatened by insolvency". In the *Final Report* par 3.11 it was stated that "the duties of directors to have regard to the interests of creditors where there is a risk of insolvency". The government, however, decided not to include a reference to creditors in the statement on directors' duties, see the *White Paper of 2005* at par 3.10.

²⁷⁶ See ch 6 par 5.2 relating to arguments for and against a codification of directors' duties.

²⁷⁷ The *Strategic Framework*, *Developing the Framework*; *Completing the Structure*; the *White Paper of 2005* and the Companies Bill are discussed. Reference is also made to the *Law Commission Paper No 153 Scottish Law Commission Paper No 105 "Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Directors' Duties"* (September 1998) available at <http://www.lawcom.gov.uk/library/lc261/lc261.pdf> (hereafter *Law Commission 153, 105 Paper*) as well as the *Law Commission and Scottish Law Commission "Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties"* No. 261, SLC No 173 (1999) paper available at <http://www.lawcom.gov.uk/library/lc261/lc261.pdf> (hereafter *Law Commission 261 Paper*). These two papers refer to the codification of directors' duties extensively.

²⁷⁸ *Developing the Framework* pars 3.17–3.19; *Completing the Structure* par 3.3.

Document entitled “Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Directors’ Duties”²⁷⁹ issued by the Law Commission in 1998 is largely relied on in support of the view that directors’ duties should be codified.²⁸⁰ In this document of 1998 the Law Commission considered whether part X of the 1985 Companies Act dealing with provisions that regulate transactions in which directors have a conflict of interest should be reviewed with the view to simplifying it.²⁸¹ It was stated that if directors’ duties are made more accessible through a statement of duties, then it may lessen the need to legislate for conflicts of interest situations in such a complex manner as currently embedded in part X of the Act.

The Steering Group also considered whether a statutory statement of directors’ duties is the preferred way to regulate this aspect of company law and whether or not such a codification should be an exhaustive or a partial code.²⁸² It was explained in the Consultation Paper of 1998²⁸³ that directors’ duties would be made more accessible through a statement, making detailed regulation of conflicts of interest of directors unnecessary.²⁸⁴ Several questions were therefore identified for consultees to consider. These questions included whether or not detailed amendments should be made to part X of the 1985 Companies Act, whether or not directors’ duties should be codified and, if so, whether or not this should be a comprehensive or a partial codification.²⁸⁵

²⁷⁹ In this Consultation Document only the *Law Commission 153, 105 Paper* is referred to. In September 1999 a further paper was issued, the *Law Commission 261 Paper*. The *Law Commission 261 Paper* is referred to in *Developing the Framework*.

²⁸⁰ Chapter 7 of the *Strategic Framework*.

²⁸¹ The *Strategic Framework* par 7.2. The provisions in part X of the Companies Act of 1985 were very detailed and fragmented in some respects. It proved to be a defective regulation of directors’ duties.

²⁸² The *Strategic Framework* par 7.7.3.

²⁸³ *Law Commission 153, 105 Paper* pars 3.11–3.20. See s 175 of the Companies Act of 2006 dealing with conflicts of interest.

²⁸⁴ The *Strategic Framework* par 7.5.

²⁸⁵ The *Strategic Framework* pars 7.14–7.16.

Part A of the Consultation Paper deals with the first question, namely, whether or not amendments should be made to part X of the Companies Act of 1985.²⁸⁶ For purposes of this thesis, part B of the Law Commission's Consultation Paper is important and is discussed below.

Part B of the Consultation Paper²⁸⁷ considers the possibility of a statutory statement of directors' duties. A number of options were considered by the Law Commission of 1998 relating to such a possible codification. These options include a comprehensive codification of all the duties under the general law; a partial codification of the duties that are not in doubt; a statutory statement of the main duties of directors under the general law, but which does not replace the general law; and a non-binding statement of directors' duties.²⁸⁸ A draft statement of the main duties of directors is attached to the *Strategic Framework* Consultation Paper, as Annexure "H".²⁸⁹ The *Strategic Framework* relied on the Law Commission Paper of 1998 and supported the proposal of a codification of directors' duties. It is, however, unclear at this stage how comprehensive such a code should be. The Law Commission of 1998 suggested that directors should sign a statement, in order to confirm that they did read the statement. They proposed pamphlets explaining directors' duties to them in clear language as a

²⁸⁶ Issues such as whether or not directors should disclose all interests to the board, or only those interests that are material, and if they only need to disclose material interests how "material" should be defined were addressed in part A. Part A of the *Strategic Framework* also considered whether part X should be written in more simplified language; see the *Law Commission 153, 105 Paper* pars 9.34–9.43.

²⁸⁷ *Law Commission 153, 105 Paper* pars 14.22–14.40.

²⁸⁸ The *Strategic Framework* par 7.14. See the *Law Commission 153, 105 Paper* pars 14.22–14.31.

²⁸⁹ This draft statement of directors' duties includes duties of obedience, not to make secret profits, and a duty of care, skill and diligence. In terms of the duty of obedience, a director must act in accordance with the company's constitution and he must exercise his powers only for the purposes allowed by law. The secret profit rule states that a director must not use the company's property, information or opportunities for his own or anyone else's benefit, unless he is allowed to by the company's constitution or the use has been disclosed to the company in general meeting and the company has consented to it. A director must also act with the necessary care, skill and diligence by having both the knowledge and experience that may reasonably be expected of a person in the same position as the director; and the knowledge and experience which the director have. There is also a provision in the statement indicating that directors should sign the statement acknowledging its contents. The statement of the Law Commission was developed as a non-legislative statement at a high level of generality, see par 3.18 of *Developing the Framework*. See Birds "The Reform of Directors' Duties" 151.

possible method of making these duties more accessible to directors.²⁹⁰ The Law Commission did not, however, consult on the contents of a statement of directors' duties.²⁹¹

The Law Commission of 1998 states that such a codification will make the law more accessible; and accessibility is one of the guiding principles of the company law reform.²⁹²

4.2.4.2 *Developing the Framework*

Directors' duties are also considered in *Developing the Framework*.²⁹³ In their consideration of a possible codification of directors' duties, in *Developing the Framework*, the Steering Group accepts the Law Commission's 1999²⁹⁴ proposal of a legislative restatement of directors' duties and significant changes to part X.²⁹⁵ The Steering Group points out that the possible lack of flexibility is the main disadvantage of a codification of directors' duties. The Law Commission also stated in its 1999 report that inflexibility should be dealt with by ensuring that the statement is at a high level of generality, and that it should be an exhaustive and binding statement of law, but that the courts should not be prevented from inventing new principles outside the field.²⁹⁶ The Steering Group also refers to a survey that the Law Commission

²⁹⁰ The *Strategic Framework* par 7.15. See the *Law Commission 153, 105 Paper* par 14.42. The Law Commission also refers to the duty of care and skill, and especially the standard of care and skill that is expected of a director. They also debated whether or not this duty should be purely subjective, thus only considering the knowledge and experience of the specific director or purely objective, considering the knowledge and experience of a reasonable person in the position of the director. They preferred the "twofold" test, relying on both the objective and subjective standard. See the *Strategic Framework* par 7.16; see also the *Law Commission 153, 105 Paper* part 12.

²⁹¹ Arden "Reforming the Companies Acts" 587.

²⁹² Birds "The Reform of Directors' Duties" 155.

²⁹³ Part 1, ch 3 of *Developing the Framework*.

²⁹⁴ *Law Commission 261 Paper*.

²⁹⁵ Paragraph 4.2.4.1 above.

²⁹⁶ *Developing Framework* par 3.15. Earlier case law may be considered when interpreting the provisions in the code (of directors' duties), but new case law should be consistent with the code.

conducted in 1998, noting that directors are in favour of such a statement and that a number of directors indicated that they were uncertain of their duties.²⁹⁷

In *Developing the Framework*, based on the 1998 Law Commission's draft statement of directors' duties, a trial draft statement of duties with explanations is provided. It is confirmed that the main aim is to have a statement that is both flexible and accessible. The statement must be at a sufficiently high level of generality to give judges appropriate flexibility to develop and adapt law to meet new circumstances. It should also be simple, short and accurate enough to give comprehensive and useful guidance to company directors.²⁹⁸

The draft statement in *Developing the Framework* is based on five principles, namely (1) compliance and loyalty,²⁹⁹ (2) independence of judgement, (3) conflict of interest, (4) fairness and (5) care, skill and diligence.³⁰⁰ It is important to consider the trial statement, as it was used as a basis for the code of directors' duties in the 2006 Act.

The trial draft statutory statement of directors' duties, contained in *Developing the Framework*, reads as follows:³⁰¹

The general duties of a director of a company

Preamble

The performance of a director's functions is governed by the following general principles:

1 Compliance and Loyalty

a. A director must exercise his powers honestly and for their proper purpose, and in accordance with the company's constitution and decisions taken lawfully under it

²⁹⁷ *Developing Framework* par 3.14. The draft statement of directors' duties, drafted by the Law Commission of 1998 (*Law Commission 153, 105 Paper*), is also attached to *Developing the Framework* for reference and comparison purposes.

²⁹⁸ Paragraph 3.37 of *Developing the Framework*.

²⁹⁹ This principle relates to the question in whose interests directors should manage a company, which is discussed in more detail below.

³⁰⁰ Paragraphs 3.40–3.67 in *Developing the Framework*.

³⁰¹ *Developing the Framework* par 3.40. See Jones "Directors' Duties" 364–368 discussing the draft statement of directors' duties as contained in the *2005 White Paper*.

b. Subject to that requirement, he must (so far as he practically can) exercise his powers in the way he believes in good faith is best calculated in the circumstances, taking account of both the short and the long term consequences of his acts, to promote the success of the company for the benefit of its members as a whole.

c. The circumstances to which he is to have regard for that purpose include, in particular, (as his duties of care and skill may require):

aa. the company's need to foster its business relationships, including those with its employees and suppliers and the customers for its products and services;

bb. the impact of its operations on the communities affected and on the environment; and

cc. its need to maintain a reputation for high standards of business conduct.

2 Independence of Judgement

a. A director must not (except as lawfully permitted under the company's constitution) restrict his power to exercise an independent judgement.

b. But this does not prevent him doing anything necessary to carry out an agreement entered into in accordance with his duties.

3 Conflict of Interest

A director must not:

a. authorise, procure or permit the company to enter into any transaction in which he has an interest unless the interest has been disclosed to the relevant directors to the extent required under the Act; nor

b. use any property, information or opportunity of the company for his own or anyone else's benefit, nor obtain a benefit in any other way in connection with the exercise of his powers, unless he is allowed to make such use or obtain such benefit by the company's constitution, or the use or benefit has been disclosed to the company in general meeting and the company has consented to it.

4 Fairness

A director must act fairly as between the company's members.

5 Care, Skill and Diligence

A director must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with both the knowledge, skill and experience which may reasonably be expected of a director in his position and any additional knowledge, skill and experience which he has.

This statement can be explained as follows:

The first duty of compliance refers to the duty to obey the law and the constitution of a company. Directors can only use their powers for their proper purpose.³⁰² Loyalty refers to the exercise of all powers for one overall objective, namely in good faith taking both short- and long-term circumstances of the directors' specific actions into account.³⁰³ It is specifically stated that the directors should promote the success of the company for the benefit of the shareholders as a whole.³⁰⁴ It is therefore clear from this Consultation Paper that shareholders are still the primary beneficiaries of directors' duties.³⁰⁵ In order to promote the success of the company, for the shareholders collectively, directors need to have regard to a number of factors. The company's need to foster business relationships, the impact of its operations on the community affected as well as the need to maintain a reputation for high standards of business conduct are examples of factors that have to be considered. This list is, however, not exhaustive and directors will have to use their own discretion as to what is relevant and what not.³⁰⁶

Principle 2 relates to independence of judgement. Directors may not commit themselves to act according to someone else's wishes.³⁰⁷ Directors should maintain their independence. Delegation can, however, be authorised by the constitution of the company. Care and skill is necessary when directors select someone to act on their behalf and in the monitoring of such a delegate.³⁰⁸

³⁰² The duty to use powers only for a proper purpose is not defined; it is left to case law to develop this duty. See *Developing the Framework* par 3.47. See par 3.1 above where the duty of a director to act for a proper purpose is discussed.

³⁰³ Directors often only act with the short-term consequences in mind, due to pressure from shareholders.

³⁰⁴ *Developing the Framework* par 3.54.

³⁰⁵ Directors will still consider the interests of other groups, as far as is practically possible. See *Developing the Framework* pars 3.50–3.53.

³⁰⁶ *Developing the Framework* par 3.56.

³⁰⁷ Directors should exercise an unfettered discretion, see *Kregor v Hollins* (1913) 109 LTR 225 (CA) and *Clark v Workman* (1920) 1 IR 107 (it is improper for directors to give undertakings to third parties "that they will look after their interests"). See Sealy *Cases and Materials* 293.

³⁰⁸ *Developing the Framework* pars 3.59–3.60. See principle 5 (par 3.66) on the duty of care, skill and diligence. This duty is also discussed in par 3.2 above.

Principle 3 concerns conflicts of interests. A director is not allowed to participate in any transaction where his personal interest may conflict with that of the company, unless permitted in terms of the constitution. Directors must account to the company for any benefit derived from any transaction in which the director has an interest, whether or not the director participated in the transaction.³⁰⁹ The constitution of the company may, however, provide that it is not necessary for a director to account for any benefit derived from a transaction. Section 317 of the Companies Act of 1985³¹⁰ imposed an obligation on a director to disclose any interest to the board of directors. Companies usually permit directors to have such interests. According to the trial statement, directors may only have personal interests if these interests have been disclosed to the board of directors. This obligation will not, however, arise if the director had not authorised, procured or permitted a transaction in which he has an interest.³¹¹ A conflict of interests can arise if a director exploits an asset which belongs to the company, including a business opportunity, for his or her own benefit or for the benefit of someone else.³¹² It is not clear whether this also includes opportunities that a director heard of outside the course of his functions as a director. The courts will have to provide guidance on this issue.³¹³ A conflict of interest can also arise if a director receives a benefit in connection with the exercise of his or her duties. The company's constitution or the general meeting can, however, authorise such benefits.³¹⁴

³⁰⁹ Thus, a director who did not participate in a specific transaction will still have to account to the company.

³¹⁰ See par 3(a) of the statement above.

³¹¹ See *Developing the Framework* par 3.62. See Keay "Shareholder Primacy" examining the principle of enlightened shareholder value being based on shareholder primacy.

³¹² See the first part of par 3(b) of the statement above. Section 175 of the 2006 Companies Act deals with possible conflicts of interest between a director and a company, see par 4.3.1 below.

³¹³ It would be wise for the director to seek a waiver from the general meeting in such a case. See *Developing the Framework* par 3.63.

³¹⁴ See the second part of par 3(b) of the statement above.

Principle 4 concerns fairness, indicating that directors should treat all shareholders with equal fairness.³¹⁵

The last principle concerns a director's obligation to act with care, skill and diligence. This relates to the standard that directors should satisfy when they exercise their duties as imposed by the other principles. The question is whether an objective or subjective test should be followed to determine whether a specific director acted with the necessary care and skill. In *Developing the Framework*, a test containing both an objective and a subjective element was suggested. It was proposed that a director will be liable if he failed to show the care or skill of a reasonable person in his position, taking into account any additional knowledge, skills or experience that the specific director may have.³¹⁶

The possibility of a business judgment defence³¹⁷ was also considered in *Developing the Framework*. The business judgment rule states that a director will escape liability for an unsound business decision if the decision was taken on an informed basis and the decision was rational. The business judgment rule originated in the United States and states that a director who acts in good faith and with due care in the process of decision making will not be liable if the decision itself was not one that would have been made by the ordinary prudent person.³¹⁸ The plaintiff who alleges that a director

³¹⁵ *Developing the Framework* par 3.65. Directors do not have to treat all shareholders equally, but they are not allowed to discriminate unreasonably between shareholders.

³¹⁶ *Developing the Framework* pars 3.66–3.68.

³¹⁷ Directors have to take a number of risks when managing a company. Some of these risks will not pay off. There may be a danger that courts will apply hindsight in such cases, and reach unduly harsh conclusions based on alleged lack of care and skill. This is the main argument in favour of a business judgment rule or defence (the business judgment rule is a “safe harbour” for directors. Courts will not interfere with business decisions taken by directors if they acted reasonably within their duties). United Kingdom courts do, however, show a reluctance to enter into the merits of commercial decisions. The government is therefore not in favour of a statutory business judgment rule (see par 3.69 of the *2005 White Paper*). See ch 4 par 3.3 below where the business judgment rule as applied in Australia is discussed.

³¹⁸ See *Aronson v. Lewis* 473 A.2d 805 Supreme Court of Delaware, 1984 at 473, the business judgment rule is defined in this case as “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company”. See Hippert “The Business Judgment Test” 18–20; Giraldo *The Business Judgment Rule* on the business judgment rule. See also on the business judgment rule in the South African context: Lombard “Importation of a Statutory Business Judgment Rule” 614; McLennan “Duties of Care and Skill” 94; Havenga “The Business Judgment Rule” 25–37. Lombard

failed to comply with this duty of care and skill would have to rebut the presumption of the business judgment rule and prove that the director did not comply with these criteria. The business judgment rule can have the effect of courts applying hindsight with unduly harsh consequences for directors. Courts are therefore usually reluctant to enter into the merits of commercial decisions taken by directors.³¹⁹ The Steering Group opposed a legislative business judgment rule in *Developing the Framework*.³²⁰

4.2.4.3 *Completing the Structure*

In *Completing the Structure* it was stated that only a small number of respondents were opposed to a statutory statement of directors' duties.³²¹ The general view was that such a statement of directors' duties would address the need for clarity and certainty on the duties of company management.³²² A number of concerns were raised in *Developing the Framework* regarding a statement of directors' duties in general, as well as the specific contents of such a statement. The concerns and questions are considered in *Completing the Structure*.³²³

The first concern is that of the relationship between a statutory statement and the common law. This type of statement must be written in very general terms in order

argues against the rule. A statutory business judgment rule would offer limited protection. The business judgment rule only protects directors from compensation liability not resulting from the exercise of their powers for an improper purpose. There is also uncertainty as to the exact parameters of the rule and its application. A statutory business judgment rule would also confuse two separate duties, namely the duty of care and skill and a director's fiduciary duty of good faith. The element of the business judgment rule that presumes that a director acted with the necessary care and skill relates to the duty of care and skill in terms of South African law. The other element that presumed that a director acted in good faith without a personal interest, concerned the fiduciary duty of good faith. See on the business judgment rule in the United Kingdom: Pasban "The Business Judgment Rule" 201. This article deals with s 727 of the 1985 United Kingdom Companies Act. This section deals with the exercise of judicial discretion to protect directors. It is stated that the section allows for the incorporation of something similar to the business judgment rule, as applied in the United States. See also ss 170–181 of the 2006 Companies Act on directors' duties and specifically s 173 on a director's duty to exercise an independent judgment. It states that directors should not subordinate their powers to the will of others (see par 4.3.1 below on this duty).

³¹⁹ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) at 835.

³²⁰ *Developing the Framework* pars 3.69–3.70.

³²¹ The main concerns came from two bodies representing lawyers, who indicated that a legislative statement is not achievable. See *Completing the Structure* par 3.6.

³²² *Completing the Structure* par 3.3.

³²³ *Completing the Structure* par 3.12.

for it to be capable of judicial development. The Steering Group believed that this is achieved by the current draft of the statement of directors' duties in *Developing the Framework*.

Second, in *Developing the Framework* the Steering Group included a duty to act honestly. This duty is now removed from the trial statement as people can interpret the term "honest" in different ways. Such a duty can result in directors acting against the benefit of the company as a whole.³²⁴

Third, a number of concerns were raised regarding the duty of loyalty in paragraph 1 of the trial statement, quoted on pages 99–100 above. First, the hierarchy of duties listed in the trial statement caused some confusion.³²⁵ The Steering Group proposed that the duty of directors to comply with the constitution and to use their powers for a proper purpose should be overriding.³²⁶ Only when these duties are complied with are directors bound to promote the success of the company for the benefit of the members.³²⁷ Second, a director's duty to act in good faith in the interests of the company requires the director to consider the short- and the long-term consequences of his acts. This does not mean that directors should give effect to the long-term consequences if there are none, or if they, in good faith, regard them as immaterial.³²⁸ Third, "for that purpose",³²⁹ in principle 2(c) of the trial statement in *Developing the Framework*, was said to be unclear.

The drafters of *Completing the Structure* therefore suggested that paragraph 1 of the trial statement be amended as follows in order to clarify the hierarchy of duties:

³²⁴ *Completing the Structure* pars 3.12–3.15.

³²⁵ *Completing the Structure* par 3.15.

³²⁶ *Completing the Structure* par 3.15.

³²⁷ See pars 1(a) and (b) of the trial draft statement in *Developing the Framework* par 3.40.

³²⁸ *Completing the Structure* par 3.18.

³²⁹ In other words, in determining in good faith what is judged to be most conducive to the overall directors' statutory objective of success for the benefit of the members.

1. to obey the constitution and decisions of the company which bind the director;
2. to promote what he calculates in good faith to be likely to promote success for members' benefit; and
3. as part of that process, to take account of the factors (after identifying and assessing them in accordance with his duty of care and skill) which he believes in good faith to be relevant for that purpose including (where he believes them relevant) the matters listed in paragraph 1c.³³⁰

No major concerns were raised regarding principle 2 of the trial statement relating to a director's independence of judgement.³³¹ Principle 3 concerns conflicts of interests and raised a few concerns. The trial statement does not resolve the issues that may arise if a person is a director of more than one company, with conflicting interests. The effect of the provision is, however, that a director has to declare a material interest in the case of a transaction where he can make a secret profit.³³²

4.2.4.4 *The White Paper of 2005 and the Companies Bill*

The *White Paper of 2005* contains the government's proposals regarding the company law review recommendations. Directors' duties are discussed in paragraph 3.3 of chapter 3 of the *White Paper of 2005*. The *White Paper* confirms that the general duties of directors are currently found in case law, but that the Law Commissions of 1998 and 1999 and the Steering Group³³³ proposed that there is a need to make the law more accessible and certain. The government therefore agreed that directors' duties should be codified in a statutory statement.³³⁴ The intention was that this statutory statement should be exhaustive and replace the existing common law. The *White Paper of 2005* recommended that the duties of directors would be owed to the company for the benefit of its members as a whole.³³⁵ The statement of

³³⁰ *Completing the Structure* par 3.19.

³³¹ *Completing the Structure* par 3.25.

³³² *Completing the Structure* par 3.25. See par 3.1 above on "secret profits".

³³³ See the *Strategic Framework*; *Developing the Framework*; *Completing the Structure* and the *Final Report* discussed above.

³³⁴ The *White Paper 2005* par 3.3.

³³⁵ The *White Paper 2005* par 3.3.

directors' duties should be drafted in a way that reflects modern law needs and wider expectations of responsible business behaviour.³³⁶

The Company Law Bill was introduced in the House of Lords on 1 November 2005 and was brought forward to the House of Commons on 24 May 2006. The Bill completed the Commons Committee stage on 20 July 2006. Part 10³³⁷ of the Companies Bill of 2006 deals with directors and replaces parts 9,³³⁸ 10 and 25³³⁹ of the Companies Act of 1985. Part 10 in the Companies Bill contains the new exhaustive statutory statement that was proposed in respect of directors' duties.³⁴⁰ The Steering Group opted for a codification of director's duties, mainly to provide clarity on what is expected of directors and to make the law more accessible.³⁴¹

³³⁶ The *White Paper of 2005* ch 3 par 3.3.

³³⁷ See clauses 154–246 of the Companies Bill. Chapter 1 of part 10 deals with the appointment and removal of directors, chapter 2 deals with the duties of directors, chapter 3 deal with the declaration of interest in existing transaction or arrangement, chapter 4 deals with transactions with directors requiring approval of members, chapter 5 deals with service contracts of directors, chapter 6 with contracts with a sole member who is a director, chapter 7 with directors' liability, chapter 8 with the director's residential address, chapter 9 with supplementary provisions. See Harris "Company Law Reform Bill" 95–96 on criticisms from the Law Society concerning the Company Law Reform Bill. He refers to the codification of directors' duties in part 10 of the Bill and that the codification should clarify the duties that directors owe to a company. The Law Society supports the aim of clarification, but feels that this aim has not been achieved. According to the Law Society the new duties of directors will lead to greater uncertainty and increased costs.

³³⁸ Containing provisions relating to directors.

³³⁹ Dealing with confidentiality orders.

³⁴⁰ The statutory statement departs from the current law in two aspects. First, clause 176 provides that transactions or arrangements with the company do not have to be authorised by either the shareholders or by the board, but that these interests should be declared to the other directors. Secondly, dealings by a director with third parties should be authorised by the board (the director whose own interests are concerned should not participate in the authorisation).

³⁴¹ See *Explanatory Notes on the Company Law Reform Bill 190* available at www.publications.parliament.uk/pa/cm200506/cmbills (accessed 28 August 2006) (hereafter the *Explanatory Notes on the Bill*). These notes are, however, based on the Company Law Reform Bill of 24 May 2006 and not on the Companies Bill of 20 June 2006. See also Keay "Enlightened Shareholder Value" where he discusses the enlightened shareholder value principles as applied by the Steering Group in the *White Paper* and the Companies Bill. See further Arsalidou "Shareholder Primacy" 67–69 arguing that the Bill, in clause 173, does not oblige directors to consider the interests of other stakeholders, it is only a general obligation to consider the interests when and if the directors seem fit. He furthermore states that the language of the Bill (especially clause 173) is vague and imprecise and allows directors to pay lip service to the factors listed when managing a company.

Part 10 of the Companies Bill regulates the appointment and removal of directors. All companies are required to have directors.³⁴² A private company should have at least one director and a public company two.³⁴³ At least one director should be a natural person.³⁴⁴ Chapter 2 concerns the general duties of directors.³⁴⁵ These duties are owed by the directors, including *de facto* directors.³⁴⁶ These general duties set out how directors should behave, but does not indicate in detail what they should do. As stated before, these duties are currently derived from the common law and case law, and are not regulated in legislation. It is stated that these duties should be applied in the same way as common law rules. The courts should also interpret these duties in a way that reflects the nature of the rules and the principles they replace.³⁴⁷ When interpreting these duties, courts can refer to the common law.³⁴⁸

These statutory duties do not cover all the duties that a director owes to the company.³⁴⁹ Some duties remain uncoded, such as the duty to consider the interests of creditors in cases of possible insolvency.³⁵⁰ Many of the duties will overlap. For example, the duty not to take a bribe from a third party, the duty not to accept benefits from third parties³⁵¹ and the duty to promote the success of the company for

³⁴² A company is a legal person and cannot act on its own. Directors, as natural persons, act on behalf of a company.

³⁴³ Clause 154 of the Companies Bill. See also ss 282, 292, 303 of the Companies Act of 1985.

³⁴⁴ Clause 155 of the Companies Bill. See clauses 156–170 regarding the remainder of clauses dealing, *inter alia*, with the appointment of directors, the register of directors, particulars of directors and the removal of directors. See also s 282 of the Companies Act of 1985.

³⁴⁵ Clauses 171–182 of the Companies Bill; pars 279–341 of the *Explanatory Notes on the Bill*. Directors' duties were not regulated in the 1985 Companies Act.

³⁴⁶ See clauses 250, 251 of the Companies Bill for the meaning of a director.

³⁴⁷ Clause 171 of the Companies Bill.

³⁴⁸ Clause 171(4) of the Companies Bill.

³⁴⁹ Many duties are contained elsewhere in the Bill, for example, the duty to deliver accounts and reports to the registrar of companies (clause 452 of the Companies Bill). See the discussion in par 4.3.4 below on whether the code of directors' duties is truly exhaustive.

³⁵⁰ See par 3.1.3 above.

³⁵¹ Clause 177 of the Companies Bill.

the benefit of the members³⁵² clearly overlap. Companies may impose further duties upon directors through their articles of association. The articles may not, however, water down these statutory duties.³⁵³

Various duties have been codified.³⁵⁴ The first duty concerns the duty to act within the powers conferred upon a director and for a proper purpose.³⁵⁵ The specific circumstances will indicate what constitutes a proper purpose. It is also stated that a director should comply with the constitution of a company.³⁵⁶ The second duty provides that a director must promote the success of the company for the benefit of the shareholders as a whole by having regard to certain factors listed.³⁵⁷ This duty is in line with the enlightened shareholder value approach, as advocated by the company law reform process and the *White Paper of 2005*. The factors to be considered are listed in clause 173 of the Companies Bill, and include the interests of company employees and the impact of the company's operations on the community. However, the list is not exhaustive.³⁵⁸ The third duty is to act with reasonable care, skill and diligence. Traditionally, a greater degree of care and skill than may reasonably be expected from a person with that director's knowledge and experience

³⁵² Clause 173 of the Companies Bill.

³⁵³ Clause 172 of the Companies Bill.

³⁵⁴ See the *Explanatory Notes on the Bill*.

³⁵⁵ See clause 172 of the Companies Bill. On the duty to act for a proper purpose, see *Hely-Hutchinson v Brayhead Ltd* (1968) 1 QB 3 All ER 98 (Court of Appeal); *Freeman and Lockyer v Buckhurst Properties (Mangal) Ltd* [1964] 2 QB 480 (CA) stating that the validity of an act that is not in accordance with the company's constitution depends upon the rules of agency. If powers were exercised for a variety of purposes, then the "substantial" or "dominant" purpose will be relevant: *Hindle v John Cotton Ltd* (1919) 56 SLR 625 at 631. Also the Australian case of *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 (HCA).

³⁵⁶ See clause 172 of the Companies Bill. Directors should not act for any collateral purposes: *In Re Smith & Fawcett Ltd* [1942] 1 Ch 304 (CA) at 306. The powers given to the directors by the articles must not be exercised for an improper purpose: *Vatcher v Paull* [1915] AC 372 at 378.

³⁵⁷ See clause 173 of the Companies Bill. See par 4.3.3 below on s 172(1) of the Companies Act of 2006. See Schall et al. "Promoting an Inclusive Approach" 326–327, where it is argued that clause 173 of the Companies Bill will put pressure on directors to follow an inclusive approach, keeping the interests of stakeholders in mind when managing a company. But the issues of priority between different stakeholders and the lack of direct enforcement will lead to uncertainty. For stakeholders' interests to be recognised a shift in the mindset of directors will have to occur.

³⁵⁸ The Guidance of Key Clauses issued with the Bill makes this clear. See McKenzie-Skene "Directors' Duties to Creditors" 521. See also Keay "Enlightened Shareholder Value" and Dignam "Lamenting Reform?" 292 on the approach followed in the Companies Bill.

was not expected of directors (the subjective test).³⁵⁹ The provision, including an objective and subjective element, now reads as follows:

A director owes a duty to his company to exercise the same standard of care, skill and diligence that would be exercised by a reasonably diligent person with:

- a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in relation to that company (an objective test); and
- b) the general knowledge, skill and experience that the director actually has (a subjective test).³⁶⁰

A director should, in terms of this provision, have acted with care and skill that a reasonable person in the same position as the director, would have exercised.

Other duties of directors include the duty to exercise independent judgement,³⁶¹ the duty to avoid conflicts of interest,³⁶² the duty not to accept benefits from third parties³⁶³ and the duty to declare an interest in a proposed transaction or arrangement.³⁶⁴

Before discussing the new codification of directors' duties as regulated in the Companies Act of 2006, it is important to consider the codification of directors' duties generally and to decide whether such a codification should be partial or exhaustive. This matter was considered by the Steering Group during the company law reform process. The question was also raised by the Law Commission in 1999.³⁶⁵ In *Developing the Framework*, an exhaustive code is proposed. "Exhaustive" is interpreted as not leaving room for judges to develop new principles concerning

³⁵⁹ See par 3.2 above on the duty of care and skill.

³⁶⁰ Clause 175 of the Companies Bill.

³⁶¹ Clause 174 of the Companies Bill.

³⁶² Clause 176 of the Companies Bill.

³⁶³ Clause 177 of the Companies Bill. See par 3.1 above on these duties in terms of the common law.

³⁶⁴ Clause 178 of the Companies Bill.

³⁶⁵ *Law Commission 153, 105 Paper*.

directors' duties.³⁶⁶ Provisions in other legislation will, however, still be applicable and need not necessarily be entrenched in this statement. In *Completing the Structure*, the point is made that this statement of directors' duties should be exhaustive, thus not open to courts to develop new principles, as opposed to developing the existing principles.³⁶⁷ In the *White Paper of 2005* it is held that "[i]t is important that the statement of duties enables the law to respond to changing business circumstances and needs. It will therefore leave scope for the courts to interpret and develop its provisions in a way that reflects the nature and effect of the principles they reflect."³⁶⁸ Against the background of these consultation papers it is clear that an exhaustive code of directors' duties is proposed. Courts should not be able to develop new principles, but they should be able to refer to existing cases to interpret the duties of directors.

4.2.5 Conclusions

In the above section the company law review process was discussed focusing on the various consultation documents and the Companies Bill of 2006. Two issues were focused on, namely (1) the protection afforded stakeholders and (2) the codification of directors' duties. It is clear that the consultation documents and the Bill favour the enlightened shareholder value approach.³⁶⁹ Directors should manage a company in the best interests of the shareholders collectively. They should, however, adopt an inclusive approach by considering short- and long-term consequences, as well as the interests of various other stakeholders when they manage a company. The consultative documents and the Companies Bill state that directors' duties should be codified in an exhaustive code.³⁷⁰ This implies that courts cannot develop new principles, but they can refer to previous cases to interpret the principles as contained in the code. In the next section the Companies Act of 2006 is evaluated against the background of the recommendations made by the Steering Group.

³⁶⁶ *Explanatory Notes on the Act* at pars 305; 326.

³⁶⁷ *Completing the Structure* par 3.31.

³⁶⁸ The *White Paper of 2005* par 3.3.

³⁶⁹ Paragraph 4.2.3 above.

³⁷⁰ Paragraph 4.2.4.4 above.

4.3 The Companies Act of 2006

4.3.1 Introduction

The Companies Act of 2006 received royal assent on 8 November 2006.³⁷¹ Some of the sections in the Act have already come into force, and the other provisions will come into force during 2008 and 2009.³⁷² All of the provisions should be effective by October 2009. The Act with its 1 299 sections is the longest-ever Companies Act in the United Kingdom.

One of the most important changes to the previous company legislation is the statutory statement of directors' duties.³⁷³ The Act also contains a new procedure for the enforcement of these duties.³⁷⁴ Sections 170–187 concern directors' duties³⁷⁵ and sections 260–264 deal with derivative actions.³⁷⁶ Section 172(1) is of specific importance as it deals with the protection of stakeholders. In the next section of this thesis, sections 171–177 dealing with the general duties of directors and sections 182–187 dealing with declarations of interests are discussed, followed by a detailed evaluation of section 172(1).

4.3.2 Directors' Duties in Terms of the 2006 Companies Act

Chapter 2 part 10 of the Companies Act regulates company directors. Sections 154–156 deal with the requirement that each company should have directors. A private

³⁷¹ See "Legislative Comments" in the *Company Lawyer* of (2007) 28 at 144–145 and 2007 (28) at 46. See also Steinfeld et al. *The Companies Act 2006* 1–10 who provides an overview of the new Companies Act.

³⁷² See www.berr.org.uk for the commencement timetable.

³⁷³ Sections 170–174 and 178–179 dealing with general duties of directors came into force on 1 October 2007. But the duty to avoid conflicts of interest and not to accept benefits from third parties (sections 175–177) will only be effective from 1 October 2008. Sections 182–187 on declarations of interests will also come into force on 1 October 2008.

³⁷⁴ See *Corporate Update: Special Client Briefing* (November 2006) by the solicitors Clifford Chance at p 2.

³⁷⁵ See Quiney *Directors' Duties* par 6. Sections 171–177 concern general duties of directors. Supplementary provisions are listed in ss 178–181 stating, for example, that a director can be in breach of more than one duty at the same time, and sections 182–187 concern the declaration of interests in existing transactions and arrangements.

³⁷⁶ See par 4.3.3.3 below on derivative actions. These sections came into force on 1 October 2007.

company must have at least one director and a public company at least two.³⁷⁷ One of the directors must be a natural person.³⁷⁸ If a company is in breach of these requirements, the Secretary of State will make a declaration requiring the company to make the necessary appointments.³⁷⁹ Sections 157–161 concern the appointment of directors. The minimum age for appointment as a director is 16 years.³⁸⁰ This does not affect the validity of an appointment that is not to take effect until the person appointed attains that age. An appointment made in contravention of this section (157) is void. However, the Secretary of State may make provision, by regulation, for cases in which a person who has not attained the age of 16 may be appointed as a director of a company.³⁸¹ Acts of a person acting as a director are valid notwithstanding that it was discovered afterwards that there was a defect in his appointment, that he was disqualified, that he ceased to hold office or that he was not entitled to vote on a specific matter.³⁸² In terms of sections 162–167 every company must keep a register of its directors containing the required particulars of a director. The register must be available for inspection at the company’s registered office.³⁸³

The Companies Act of 2006 provides for a comprehensive code of directors’ duties. Sections 171–177 set out their general duties. The scope of the general duties is listed in section 170. It states that the duties specified in sections 171–177 are owed to the company by the directors. The general duties are based on certain common law rules and equitable principles. These duties should be interpreted and applied in the same manner as common law rules and equitable principles.³⁸⁴

³⁷⁷ Section 154.

³⁷⁸ Section 155.

³⁷⁹ Section 156.

³⁸⁰ Section 157.

³⁸¹ Section 160.

³⁸² Section 161.

³⁸³ Section 162. Section 164 states which particulars of a director should be noted in the register. Sections 154, 160 and 161 came into force on 1 October 2007. Section 155–159 will be effective from 1 October 2008 and sections 162–167 from 1 October 2009.

³⁸⁴ Section 170(4). See par 3.1 above for the duties as applied in terms of the previous 1985 Companies Act. That Act did not have a statutory statement of directors’ duties.

Section 171 concerns the duty to act within the powers conferred upon a director in accordance with a company's constitution and to do so for a proper purpose.³⁸⁵ It is stated in the *Explanatory Notes on the Companies Act of 2006* that what constitutes a "proper purpose" must be ascertained in the context of the specific situation.³⁸⁶ The "company's constitution" is defined in section 17³⁸⁷ of the Act and includes decisions taken in accordance with the company's articles of association, and any resolutions and agreements of the company.³⁸⁸ The effect of the reference in section 171 of the new Act to the "company's constitution" is that there are potential risks for the unwary director who does not follow the progress of the decisions taken by the members by resolution as such resolutions fall within the definition of "the company's constitution", as defined in section 17.

Section 172 concerns the duty to promote the success of the company having regard to a number of factors.³⁸⁹ These factors include that directors should have regard to the likely consequence of any decision in the long-term; the interests of the employees; the need to foster the company's business relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly as between members of the company.³⁹⁰ This duty is evaluated in detail below.

³⁸⁵ See par 3.1 above where the traditional duty to act with a proper purpose is discussed.

³⁸⁶ Paragraph 3.2.3 of the *Explanatory Notes on the Act*.

³⁸⁷ Section 17 does not fully come into force until 1 October 2008, but comes into force for the purposes of section 171 of the Act with effect from 1 October 2007. See the *Explanatory Notes on the Act* at pars 323–324.

³⁸⁸ In s 257 it is stated that any reference to the company's constitution in this part of the Act, dealing with directors' duties, will include "[d]ecisions taken in accordance with the company's articles; and other decisions taken by the members (or a class of them) if they are virtue of any enactment or rule of law as decisions of the company, decision taken by informal unanimous consent of all the members". This is in addition to the matters listed in section 17.

³⁸⁹ See par 3.1 above on the traditional position to act in the best interests of the company.

³⁹⁰ See s 172(1) of the Companies Act 2006. See Alcock et al. *Companies Act 2006* 144–146 on this duty.

Section 173 codifies the duty to exercise an independent judgement.³⁹¹ This duty is not infringed if the director acts in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors or in any way authorised by the company's constitution.³⁹² Directors should not subordinate their powers to the will of others by way of, for example, delegation.

It is likely that possible breaches of section 173 will simultaneously result in breaches of section 172 (the duty to promote the success of the company) and section 175 (duty to avoid conflicts of interest)³⁹³ rather than establishing separate claims.

Section 174 deals with the duties of care, skill and diligence.³⁹⁴ It was discussed above that the standard of care and skill that a director had to apply when managing a company was traditionally quite low.³⁹⁵ The modern view is a stricter and more focused approach, based not only on subjective standards, but also on objective ones.³⁹⁶ The government specifically stated that the new law is modelled on section 214 of the Insolvency Act of 1986.³⁹⁷ When directors exercise their duty to promote the success of the company in terms of section 172, they must bear their duties of care and skill in mind. In other words, this duty of care and skill will be relevant when directors act in terms of section 172. When directors determine which of the factors listed in section 172 are relevant to a business decision and to what extent they need to be taken into account, they should act with the necessary care and skill.

³⁹¹ See par 3.1 above on this duty as interpreted in terms of the common law. On the new statutory duty see Alcock et al. *Companies Act 2006* 146.

³⁹² Section 173(2).

³⁹³ Which duty and section will only come into effect on 1 October 2008. See Quiney *Directors' Duties* par 41, 42.

³⁹⁴ See par 3.2 above on case law dealing with the interpretation of this duty. On the statutory duty see Alcock et al. *Companies Act 2006* 146–147.

³⁹⁵ See *Re City Equitable Fire Insurance Co* [1925] 1 Ch 407 (CA) at 428–429. This case is discussed above, see par 3.2.

³⁹⁶ See *Re D'Jan of London Ltd* (1994) 1 BCLC 561 (CD) discussed at par 3.2 above.

³⁹⁷ See the *Explanatory Notes on the Act* at par 336. It was stated in *Completing the Framework* (par 3.12) that s 214 is a carefully balanced statutory provision applicable in wrongful trading situations and should be used as a basis for the test applicable to determine whether a director breached his duty of care, skill and diligence (see also the *Strategic Framework* par 5.48).

If a director made the wrong decision as to what will promote the success of the company the decision could be open to challenge if the directors fail either the subjective or the objective test in section 174 of the Act.³⁹⁸

Section 175 provides for possible and actual conflicts of interest between a director and the company. A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.³⁹⁹ This includes conflicts that arise from the use or disposition of company property, information or an opportunity for personal interest.⁴⁰⁰ This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company; this is covered in sections 177, 182–187. This duty, in section 175, is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or if the matter has been authorised⁴⁰¹ by the directors.⁴⁰²

At present conflicts of interests should be authorised by members of the company. The Steering Group recommended that this requirement may “stifle entrepreneurial activity”.⁴⁰³ It was recommended that in the case of a private company an

³⁹⁸ This was argued by David Cabrelli at a seminar presented at Thorntons Law LLP. See also Quiney *Directors’ Duties* pars 43–46.

³⁹⁹ Section 175(1).

⁴⁰⁰ See s 175(2) stating on the duty to avoid conflicts of interest: “This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).” See Alcock et al. *Companies Act 2006* 147–148 on this duty.

⁴⁰¹ Authorisation may be given by the directors where the company is a private company and nothing in the company’s constitution invalidates such authorisation, by the matter being proposed to, and authorised by, the directors; or where the company is a public company and its constitution includes provision enabling the directors to authorise the matter. The authorisation is effective only if any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and the matter was agreed to without their voting or would have been agreed to if their votes had not been counted (see s 175(4)–(6)).

⁴⁰² Section 175(4).

⁴⁰³ The *Explanatory Notes on the Act* at par 342.

independent director should be able to authorise possible conflicts, unless the company's constitution prevents such authorisation.⁴⁰⁴

Section 176 states that a director should not accept a benefit from a third party.⁴⁰⁵ This section codifies the rule prohibiting the exploitation of the position of director for a personal benefit. For example, the duty prohibits the acceptance of bribes. Conduct in breach of section 176 could simultaneously breach section 175 as the expectation of a benefit may give rise to a potential conflict of interest. It is unclear what is meant by "a benefit". Companies might have to draft policies setting out whether or not a benefit could be accepted.⁴⁰⁶

Section 177 provides that a director should declare an interest in a proposed transaction or arrangement.⁴⁰⁷ If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of the interest to the other directors.⁴⁰⁸ The declaration may be made at a meeting of directors or by notice to the directors. The declaration must be made before the company enters into the transaction or arrangement.⁴⁰⁹

Most of the duties mentioned above are similar to the traditional duties of directors, discussed above.⁴¹⁰ It was noted that section 170(4) provides that "regard shall be had to the corresponding common law rules and equitable principles in interpreting and

⁴⁰⁴ The *Explanatory Notes on the Act* at par 344.

⁴⁰⁵ Alcock et al. *Companies Act 2006* 148–149 on this duty.

⁴⁰⁶ *Burges Salmon Briefing* (February 2007) on the New Companies Act 2006 at p 3.

⁴⁰⁷ Alcock et al. *Companies Act 2006* 149 on this duty.

⁴⁰⁸ Section 177(1).

⁴⁰⁹ Section 177(4).

⁴¹⁰ See par 3.1 above on the traditional duties of directors.

applying the general duties”.⁴¹¹ The common law principles can therefore be used when interpreting directors’ statutory duties.

Sections 182–187 deal with declarations of interest in existing transactions or arrangements. Where a director of a company is in any way, directly or indirectly, interested in a transaction or arrangement that has been entered into by the company, he must declare the nature and extent of the interest to the other directors in accordance with this section.⁴¹² This section does not apply if, or to the extent that, the interest has been declared under section 177, discussed above. The declaration must be made at a meeting of the directors, or by notice in writing⁴¹³ or by general notice.⁴¹⁴ If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.⁴¹⁵

4.3.3 Evaluation of Section 172

As stated before, the United Kingdom Companies Act 2006 provides for an exhaustive statement of directors’ duties. Section 172 of the United Kingdom Companies Act of 2006 provides as follows:

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company’s employees,
- (c) the need to foster the company’s business relationships with suppliers, customers and others,
- (d) the impact of the company’s operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and

⁴¹¹ See *Burges Salmon Briefing* (February 2007) on the New Companies Act 2006 and what it means for directors at p 2.

⁴¹² Section 182(1). A director who fails to make such declaration commits an offence, see s 183.

⁴¹³ Section 184. Section 186 and 187 concerns declarations made by a company with a sole director and by a shadow director.

⁴¹⁴ Section 185.

⁴¹⁵ Section 182(3).

- (f) the need to act fairly as between members of the company.
- (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
- (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

4.3.3.1 *Explanation of Section 172*

It is stated in the *Explanatory Notes on the Act* that this section enshrines in statute the enlightened shareholder value approach by stating that a director must promote the success of the company with reference to a number of important factors. With regard to subsection (1) it is explained that the list of factors is not exhaustive, but highlights areas of particular importance, which reflect wider expectations of responsible business behaviour, such as the interests of the company's employees. In having regard to the factors listed, the duty to exercise reasonable care, skill and diligence (section 174) will apply as discussed above.⁴¹⁶ Directors have to determine, with the necessary care and skill, which factors are relevant at what stage of the existence of a company. Subsections (2) and (3) are explained as follows in the *Explanatory Notes*:

Subsection (2) addresses the question of altruistic, or partly altruistic, companies. Examples of such companies include charitable companies and community interest companies, but it is possible for any company to have 'unselfish' objectives which prevail over the 'selfish' interests of members. Where the purpose of the company is something other than the benefit of its members, the directors must act in the way they consider, in good faith, would be most likely to achieve that purpose. It is a matter for the good faith judgment of the director as to what those purposes are, and, where the company is partially for the benefit of its members and partly for other purposes, the extent to which those other purposes apply in place of the benefit of the members. Subsection (3) recognises that the duty to promote the success of the company is displaced when the company is insolvent. Section 214 of the Insolvency Act 1986 provides a mechanism under which the liquidator can require the directors to contribute towards the funds available to creditors in an insolvent winding up, where they ought to have recognized that the company had no reasonable prospect of avoiding insolvent liquidation and then failed to take all reasonable steps to minimise the loss to creditors. It has been suggested that the duty to promote the success of the company may also be modified by an obligation to have regard to the interests of creditors as

⁴¹⁶ Paragraph 4.3.2 above.

the company nears insolvency. Subsection (3) will leave the law to develop in this area.⁴¹⁷

4.3.3.2 *Shareholder Primacy Retained*

In terms of this duty embedded in section 172, directors are primarily expected to act in good faith to promote the success of the company for the benefit of its members as a whole.⁴¹⁸ In other words, shareholder primacy has been retained. However, the directors may also have regard to other matters, including and primarily those listed in section 172(1)(a)–(f). As was mentioned above, this list is not exhaustive.⁴¹⁹ The list provided in section 172(1) is probably the most comprehensive list of factors that directors should consider when managing a company contained in any modern company legislation. It is also, probably, the clearest recognition in modern company legislation of the importance of interests apart from the interests of shareholders, namely those of other stakeholders such as employees, suppliers, customers and others.

4.3.3.3 *The Practical Application of Section 172*

The practical application of this section is, however, unclear. This uncertainty can be explained as follows: firstly, directors are provided with an unfettered (or unlimited) discretion in terms of this provision. They should manage a company in a way they consider would promote the success of the company, for the benefit of its members. But there are no objective criteria indicating how they should exercise this important discretion. According to the *Ministerial Statements* of June 2007, there are two ways of looking at the statutory statement of directors' duties. On the one hand, it codifies the existing common law obligations of company directors. On the other hand, it

⁴¹⁷ See pars 325–322 of the *Explanatory Notes on the Act*. The Steering Group was against the inclusion of creditors as beneficiaries of directors' duties.

⁴¹⁸ See Esser & Du Plessis "Stakeholder Protection" 353 and Richardson "The Companies Act of 2006" 138 on s 172(1). See further Wesley-Key "Companies Act 2006" 422–429 arguing that s 172(1) does not provide stakeholders with sufficient protection. The duty to consider the interests of stakeholders is still subjective. Miles "Company Stakeholders" 56–59 also argues that it is within the discretion of the directors whether to consider other stakeholders or not. See also Attenborough "Recent Developments in Australian Corporate Law" 312–323 stating that s 172(1) does not appear to represent a great movement away from shareholder value (at 317). Section 172(1) places merely a general obligation on directors to consider the interests of other stakeholders. Shareholders are still the primary beneficiaries of directors' duties.

⁴¹⁹ See Nakajima "Enlightened Shareholder Value" 353–354 stating that the statement of directors' duties is not an exhaustive list.

marks a radical departure in “articulating the connection between what is good for a company and what is good for society at large”.⁴²⁰

Secondly, it is stated that the new statutory statement of directors’ duties captures a cultural change in the way in which companies conduct their business. The current Minister of Justice states that she strongly believes that businesses will perform better when they have regard to a wider group of interests in pursuing success. The new Act is based on a new approach to pursuing the interests of shareholders and considering the interests of stakeholders. These approaches are complementary approaches and not contradicting ones. It therefore seems as if the Minister is arguing that there is a new emphasis in company management, namely that directors should have regard to the interests of different stakeholders. The Minister does not, however, provide any guidelines on how directors should have regard to the interests of stakeholders. It is stated in a “Corporate Update” by Ashurst⁴²¹ that section 172(1) will at least have the effect of making directors think harder about their duties.

Thirdly, the list of issues directors need to have regard to is also not exhaustive. It is specifically stated that directors need to consider these issues “amongst other matters”. There is no indication of what these “other matters” entail. Fourthly, there is no definition concerning “the success of the company”.⁴²²

Fifthly, none of the stakeholders other than shareholders will have standing to compel directors to take their interest into consideration, unless it can be established that the interest of the company itself was contravened. This will have to be done by way of a shareholder derivative action (in terms of the derivative action in sections 260–264 of the United Kingdom Companies Act of 2006).⁴²³ Section 260 sets out the key aspects

⁴²⁰ See the introduction to the *Ministerial Statements* of June 2007.

⁴²¹ See the “Corporate Update” of Ashurst of November 2006 on the Companies Act of 2006. This document was provided to me by David Gabrelli of the University of Edinburgh.

⁴²² Keay “Section 172(1)” 109.

⁴²³ This was one of the dilemmas employees faced under s 309 of the United Kingdom Companies Act of 1985. See par 3.1.4 above where s 309 of the Companies Act of 1985 is discussed. See also Du Plessis & Dine “The Fate of the Draft Fifth Directive” 23, 46; Davies *Gower’s Principles of Modern Company Law* 68; Roach “The Paradox of the Traditional Justifications for Exclusive Shareholder

of a derivative claim. There are three elements to a derivative action: (1) the action must be brought by a member of the company; (2) the cause of action is vested in the company; and (3) relief is sought on the company's behalf. Section 260(3) provides that a derivative claim "may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company". A derivative claim may therefore be brought in respect of an alleged breach of any of the general duties of directors in chapter 2 of part 10, including the duty to exercise reasonable care, skill and diligence.⁴²⁴

The extent of the protection afforded in section 172(1) is therefore uncertain. It would seem that the only practical consequence of recognising these other interests in the legislation is that the actions of directors would not be open for any challenge if they have not only taken the interests of the company as a whole (defined as the collective interest of the current and future shareholders) into consideration in making decisions, but also other interests. Under the common law, other interests, such as employees' interests, were considered to be pertinent only when they coincided with the company's best interests.⁴²⁵

4.3.3.4 *Conclusions on Section 172*

The drafters can, however, be commended for clearly stating which approach they prefer regarding the stakeholder debate. The Act seems to provide a theoretical answer to the stakeholder debate, but its practical application is far from clear. It may well be that over time guidelines on its practical application may be provided in codes of best practice. The business review is another method of ensuring that directors comply with their duties. Sections 415–419 of the Companies Act concern the directors' report. Section 417 provides what must be contained in the business review element of the directors' report. All companies, other than small companies,

Governance Protection" 12, 15. It has been said that one effect of s 309 was to dilute directors' accountability to shareholders rather than to strengthen their accountability to employees.

⁴²⁴ Section 174, discussed above. See also Paragraph 494 of the *Explanatory Notes on the Act*.

⁴²⁵ *Hampson v Price's Patent Candle Co* (1876) 45 L.J Ch 437; *Hutton v West Cork Railway Co* (1883) 23 ChD 654 (CA); and see also Klein & Du Plessis "Corporate Donations" 69; 70; 81–82; 97.

will need to produce a business review, as required by the European Union Accounts Modernisation Directive.⁴²⁶ The purpose of the review is to inform members of the company and to help them assess how directors performed their duties under section 172.⁴²⁷

The Act clearly refers to the interests of other stakeholders and to the fact that directors should have regard to the interests of other stakeholders when promoting the success of the company for the benefit of its members.⁴²⁸ Thus the Act is very clear on the preferred approach to stakeholders protection. Shareholders should still be seen as the primary beneficiaries of company's management in comparison to other stakeholders. But directors have a discretion in this regard. Directors should only consider the interests of these stakeholders when it would be in the interests of the shareholders collectively to do so.

4.3.4 Codification of Directors' Duties: Exhaustive or Partial?

The Steering Group's suggestion that the codification of directors' duties should be exhaustive was followed in the Companies Act. It is specifically stated in section 171(3) and (4) that: "(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director. (4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties." This makes the well-established law in this area more accessible and brings it into conformity with modern business practice.

It is clear from the consultation documents of the Steering Group and the *Explanatory Notes* issued with the Companies Act that the statement of directors' duties is intended to be exhaustive.⁴²⁹ It seems, however, that the new codification does not

⁴²⁶ 2003/51/EEC.

⁴²⁷ Paragraph 670 of the *Explanatory Notes on the Act*.

⁴²⁸ Section 172(1) of the Companies Act of 2006.

⁴²⁹ Paragraph 305 of the *Explanatory Notes on the Act*.

offer a complete codification of the existing law.⁴³⁰ First, the misapplication of assets by directors is, for example, not included in the code. The duty to consider the interests of creditors, as formulated in the case law, is also not included in the code.⁴³¹ It was argued above that a codification of directors' duties makes the law more certain, but is not necessarily flexible enough. It has, however, been submitted that courts can still refer to existing case law when they interpret the principles contained in a code of directors' duties.⁴³² Such a code should also be drafted as comprehensively as possible and attempt to include all the duties of directors.⁴³³

5 CONCLUSIONS

In this chapter the position in the United Kingdom was considered with reference to two issues, namely the protection of stakeholders and the codification of directors' duties.

Various corporate governance codes, the consultation documents of the company law reform committees, the Companies Bill of 2006 and the Companies Act of 2006 were considered.⁴³⁴

It was stated that the objectives of the codes of best practices were not to prescribe any specific corporate behaviour in detail. The codes are rather intended to be self-

⁴³⁰ It is clearly stated that a duty to creditors is not included and that judges can refer to case law in order to interpret the duties.

⁴³¹ See par 3.1.3 above, where it is stated that the government decided not to include creditors in s 172(1) of the new Act. See also par 3.1.3 above for the relevant case law addressing the interests of creditors.

⁴³² Paragraph 305 of the *Explanatory Notes on the Act*.

⁴³³ See, for example, the situation in Australia. There has been no recent reported case law on common law duties in Australia. All of the cases were based on statutory provisions in the Act. Du Plessis et al. *Principles of Contemporary Corporate Governance* 259 therefore argue that the statutory duties are far more important than the duties at common law or in equity.

⁴³⁴ Paragraph 4 above.

regulatory in nature.⁴³⁵ On the protection of stakeholders it was argued that the corporate governance codes, especially the *Hampel Report*, are in favour of directors managing a company in the best interests of the shareholders collectively with reference to the interests of other stakeholders.⁴³⁶ The *Cadbury* and *Greenbury Reports* did not specifically deal with the issues of stakeholder protection and in whose interests directors should manage a company. The committees did, however, equate a company's interests with those of its shareholders and they based their recommendations on this viewpoint.⁴³⁷

The various consultation documents issued by the Steering Group were considered, their viewpoints on stakeholder protection and the codification of directors' duties were focused on.⁴³⁸ First with regard to the protection of stakeholders: the Steering Group distinguished between the enlightened shareholder value and pluralist approaches, and followed the enlightened shareholder value approach.⁴³⁹ The Companies Act of 2006, following the recommendations of the Steering Group, prefers the enlightened shareholder value approach and states this in clear terms. It was argued that it is unclear how this provision will operate in practice.⁴⁴⁰ It would seem that the Act only provides a theoretical answer to the stakeholder debate, but its practical application is far from clear. It was indicated that the only practical consequence of recognising the interests of stakeholders in the Companies Act of 2006 is that the actions of directors would not be open for any challenge if they have *not only* taken the interests of the company as a whole (defined as the collective

⁴³⁵ Paragraph 4.1.1 above.

⁴³⁶ Paragraph 4.1.2 above.

⁴³⁷ Paragraph 4.1.2 above.

⁴³⁸ Paragraph 4.2.3ff above.

⁴³⁹ These approaches are also discussed in ch 2 par 5.1 above. It was, furthermore, argued that it may seem as if these two approaches are the only relevant approaches on the nature of companies, but it is submitted that the Steering Group referred to these two approaches to emphasise two possibilities when considering the interests of stakeholders, namely shareholder primacy or the protection of different stakeholders (see par 4.2.3 above).

⁴⁴⁰ The South African Companies Bill is unclear on the preferred approach. This is discussed in ch 6 below. In view of this, a proposed combined theory is recommended (see ch 2 par 5.2 above).

interest of the current and future shareholders) into consideration in making decisions, *but also* other interests.⁴⁴¹

As regards the codification of directors' duties, it was stated that the Companies Act of 2006 contains an exhaustive code of directors' duties. This was also recommended by the Steering Group during the company law review process.⁴⁴² Courts can still refer to existing case law when developing directors' duties. A statement of directors' duties relates to the contents of directors' duties. Self-regulatory codes of best practice are still relevant; especially concerning guidelines as to how directors should interpret their duties as entrenched in a comprehensive code.⁴⁴³

⁴⁴¹ Paragraph 4.3.3. above.

⁴⁴² Paragraph 4.3.4 above.

⁴⁴³ Paragraph 4.3.4 above.

CHAPTER 4

AUSTRALIAN LAW

- 1 INTRODUCTION**
 - 2 BACKGROUND**
 - 3 DIRECTORS' DUTIES**
 - 4 CORPORATE GOVERNANCE INITIATIVES AND THE
STAKEHOLDER DEBATE**
 - 5 CONCLUSIONS**
-

1 INTRODUCTION

Financial failures in Australia¹ led to corporate governance review initiatives using binding and non-binding rules, international recommendations, industry standards² and the formation of various committees and commissions.³ Australian corporate law is of comparative value when considering South African company law, because it is also based on the English common law.⁴ The recent review of Australian corporate

¹ Such as OneTel (a telecommunications company) and HIH (a general insurance company). See generally, Von Nessen "Corporate Governance in Australia" 197.

² For instance, the Corporate Law Economic Reform Programme, especially the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure Act 103 of 2004) (hereafter *CLERP 9*) amendments to, *inter alia*, the Corporations Act 50 of 2001 (hereafter the Corporations Act 2001), which deals with corporate governance reforms, including mandatory rules dealing with auditor independence, financial reporting and shareholder participation and the *Australian Stock Exchange (ASX) Corporate Governance Council's Principles of Good Governance and Best Practice Recommendations* (March 2003 and August 2007) (hereafter *ASX's Best Practice Principles and Recommendations*). These initiatives are discussed in detail below. See also, generally, Grantham "Corporate Governance Codes" 218.

³ For instance, the Australian Securities and Investments Commission (ASIC); the report by Professor Ramsay on Audit Independence in October 2001 (hereafter the *Ramsay Report*). See Von Nessen "Corporate Governance in Australia" 198 on this report. See also Du Plessis et al. *Principles of Contemporary Corporate Governance* 156 in this regard. The *Report on Corporate Responsibility: Managing Risk and Creating Value by the Parliamentary Joint Committee and Corporations and Financial Services* (June 2006) (hereafter the *Corporate Responsibility Report* of June 2006); the *Social Responsibility of Corporations Report* (December 2006) issued by the Corporations and markets Advisory Committee (hereafter the *Social Responsibility Report* of December 2006) and the *HIH Royal Commission's Report on the Failure of HIH Insurance* (2003) (hereafter the *HIH Report*) are also relevant.

⁴ See Cassidy *Corporations Law* 1ff on the historical development of corporations law as well as specific developments in Australia.

law is, furthermore, of value, especially concerning the regulation of corporate governance issues and the protection of stakeholders' interests.⁵

This chapter discusses the position in Australia. First, a brief background on Australian corporate law is provided. This is followed by a discussion on the statutory and general duties of directors in Australia. It is important to understand these duties in order to answer the question most important to this thesis: whose interests should receive primacy in the management of a company or corporation? Recent corporate governance initiatives such as the *Corporate Responsibility Report* of June 2006 and ASX's *Best Practice Principles and Recommendations* are then discussed, focusing on the views of the drafters concerning stakeholder protection.

2 BACKGROUND

Most Australian states independently enacted corporation legislation based on the English model, with certain modifications.⁶ Differences in the states' corporation legislation made it difficult for corporations to operate in more than one jurisdiction. Uniform legislation across the states was introduced in 1961 and 1962 by way of Uniform Companies Acts (based on the English Victorian model).⁷ These Acts were, however, not uniform, and with the passing of time and amendments to different state legislation, the variations increased. In 1974 the non-labour states⁸ established an Interstate Corporate Affairs Commission to provide a uniform system of corporate regulation. The commission did perform good work, but as it was confined to specific

⁵ Du Plessis et al. *Principles of Contemporary Corporate Governance* 129, 146; Du Plessis "Enkele Internasionale Maatskappyregtelike Ontwikkelings" 562.

⁶ "No liability" companies for mining projects were introduced (see the Mining Companies Act 1871 (Vic)). It also distinguished between public and proprietary companies, and required public companies to comply with compulsory audit requirements.

⁷ Cassidy *Corporations Law* 5.

⁸ These states were New South Wales, Queensland and later, after a change of government, Western Australia. These states did not want to relinquish their powers over corporate affairs to the federal government.

states, the differences stemming from disparate corporations legislation continued. In 1978 the incoming liberal government addressed this problem and negotiated an agreement with the states for a uniform companies code. The result was that in 1981 a Companies Code was enacted and adopted by each state under the Companies Act of 1981,⁹ and in 1989 the Corporations Act was promulgated.¹⁰ In the decision of *NSW v Commonwealth*¹¹ the High Court held that the Companies Act of 1989 exceeded the federal government's legislative powers because the Commonwealth Parliament lacked legislative powers to create a regime for incorporating companies.¹² The states then reached an agreement at Alice Springs,¹³ which allowed Australian company and securities law to be federalised with the compliance of the states.¹⁴

The complexity of the Corporations Law led to an extensive period of legislative activity, which resulted in the Corporations Act of 2001.¹⁵

In the late 1990s the implementation of sound practices was not first on the corporate law agenda of Australia, but was rather considered as an unnecessary burden on

⁹ Company law issues were therefore founded in the different states or territories. Although the Companies Code of 1981 was the basis for the company law of each state, there were differences between the laws of the different states. The Corporate Affairs Commission of each state was responsible for its administration. See generally, Du Plessis "Enkele Internasionale Maatskappyregtelike Ontwikkelings" 565; Cassidy *Corporations Law* 5.

¹⁰ The Australian Securities Act of 1989 and the Close Corporations Act of 1989 were also passed. These Acts were known as the *Corporations Law*. The Corporations Act introduced a national body, the Australian Securities Commission and a new business form similar to the limited partnership. The Act was amended by the Corporations Legislation Amendment Act 110 of 1990. See Du Plessis "Enkele Internasionale Maatskappyregtelike Ontwikkelings" 566; Henning & Wandrag "Oorsig van die Herkoms van die Private Maatskappy" 38; Cassidy *Corporations Law* 6.

¹¹ (1990) 8 ACLC 120.

¹² Cassidy *Corporations Law* 6.

¹³ With effect from 1 January 1991. Company law is now being administered through the Australian Securities and Investments Commission (ASIC).

¹⁴ Blackmore "Regulating Regime" 43–45. See also Baxt et al. *Corporations* ch 3; Cassidy *Corporations Law* 1 ff; Redmond *Companies and Securities Law* 47ff on the development of company law regulation in Australia and Austin et al. *Company Directors* ch 1 on corporate governance reports and principles. See also Luiz *The South African Securities Regulation Code* 235–246 for a concise historical overview of the development of Australian company legislation.

¹⁵ Blackmore "Regulating Regime" 44.

businesses. Strict corporate governance rules were blamed for the under-performance of companies.¹⁶ In 1990 a Working Group was established by several leading players in the financial sector¹⁷ and chaired by Henry Bosch.¹⁸ The abuses in the 1980s contributed to the establishment of this working group. It was not a specific scandal, such as Maxwell in the United Kingdom,¹⁹ which triggered the establishment of the working group, but rather a general move to “improve the performance and reputation of Australian businesses”.²⁰ Three *Bosch Reports* were issued, the original one in 1991,²¹ and two reports in 1993²² and 1995 that reviewed the 1991 report.²³ The *Bosch Reports* dealt with corporate governance issues and specifically with directors’ duties and responsibilities. The reports were designed as a guide for directors, auditors and accountants and related to accepted principles of corporate governance. In 1993 the *Hilmer Report* was released.²⁴ This report deals with the

¹⁶ Du Plessis et al. *Principles of Contemporary Corporate Governance* 90.

¹⁷ These leading players included the Australian Merchant Bankers Association, the Australian Stock Exchange Ltd, the Australian Institute of Company Directors and the Securities Institute of Australia. See Du Plessis et al. *Principles of Contemporary Corporate Governance* 91.

¹⁸ Former chairperson of the National Companies and Securities Commission. See Du Plessis et al. *Principles of Contemporary Corporate Governance* 91. It is interesting to note that recent Australian textbooks give little attention to the *Bosch* and *Hilmer Reports*. There is nothing, for example, on these reports in Cassidy *Corporations Law* or Tomasic et al. *Corporations Law*.

¹⁹ See ch 3 par 4.1.1 on the Maxwell scandal.

²⁰ Du Plessis et al. *Principles of Contemporary Corporate Governance* 92.

²¹ Business Council of Australia, *Corporate Practices and Conduct*, Melbourne, Information Australia (1991). The main aim of this report was “to improve the performance and reputation of Australian business by encouraging and assisting the general adoption of higher standards of corporate conduct” (see the foreword). This report introduced several principles of good governance, for example that guidelines should be provided to assist directors in carrying out their duties and responsibilities. See, generally, Du Plessis et al. *Principles of Contemporary Corporate Governance* 91; Austin et al. *Company Directors* 1.11 on the *Bosch Report*.

²² Business Council of Australia, *Corporate Practices and Conduct*, Melbourne, Information Australia (1993). There are only a few differences between the 1991 report and this one, for instance the fact that the functions of the board are explained in much more detail in the 1993 report. See also Du Plessis et al. *Principles of Contemporary Corporate Governance* 92.

²³ Business Council of Australia, *Corporate Practices and Conduct*, Melbourne, Information Australia (1995). This report added little substance to the 1991 and 1993 reports: see Du Plessis et al. *Principles of Contemporary Corporate Governance* 93–96.

²⁴ In *AWA Ltd v Daniels (t/a Deloitte Haskins & Sells)* (1992) 10 ACLC 933 Rogers CJ had to consider various issues on the duties of directors. He approached the Sydney Institute to facilitate discussions on corporate governance. The result was the *Hilmer Report: Strictly Boardroom*:

following three questions: (1) what is the principle contemporary concern about the roles of the board, directors, management and auditors? (2) What are the key functions of a board that require greater emphasis if this concern is to be addressed? (3) What is the responsibility of directors or other parties involved in corporate governance and what changes are needed in board composition and processes? In 1998 a second *Hilmer Report* was published.²⁵

In the early 2000s the corporate governance debate was reopened.²⁶ The Corporate Law Economic Reform Program (CLERP) was established to perform ongoing reviews on issues such as corporate governance. Many mechanisms²⁷ were implemented to restore good governance, with *CLERP 9* as the best example. *CLERP 9* contains the bulk of corporate governance law reforms in Australia.²⁸

A number of recent corporate governance initiatives in Australia are discussed below. This thesis focuses on *ASX's Best Practice Principles and Recommendations*, CLERP,²⁹ the *Corporate Responsibility Report* of June 2006 and the *Social Responsibility Report* of December 2006.

Improving Governance to Enhance Company Performance. See Du Plessis et al. *Principles of Contemporary Corporate Governance* 97.

²⁵ Under the same title. There were no major changes to the 1993 report. See Du Plessis et al. *Principles of Contemporary Corporate Governance* 100.

²⁶ Du Plessis et al. *Principles of Contemporary Corporate Governance* 90.

²⁷ Such as codes of good practice, continuous disclosure and the recognition of independent directors.

²⁸ Du Plessis et al. *Principles of Contemporary Corporate Governance* 111. *CLERP 9* did not deal with directors' duties and in whose interests directors should manage a company. The *CLERP 9* Act deals with, *inter alia*, financial reporting, audit reform, proportionate liability and the remuneration of executive directors.

²⁹ The discussion below focuses on *Paper 3* of *CLERP*, dealing with directors' duties.

3 DIRECTORS' DUTIES

3.1 General Law Duties versus Statutory Duties

In order to discuss stakeholder protection in Australia, it is necessary to consider directors' duties in terms of the law in this jurisdiction.

Directors' duties are classified as duties in terms of the general law as well as statutory duties. Duties in terms of the general law include duties that can arise by way of a contract, principles of equity or the common law.³⁰ Directors' duties are also entrenched in legislation. The Corporations Act of 2001 provides a partial codification of directors' duties. The common law is therefore still applicable.³¹ The statutory duties are regarded as more relevant than the general law duties.³² As is the case in South Africa, directors' duties in terms of Australian law are divided into two main categories. The first category concerns the fiduciary duties of loyalty and good faith, and the second one concerns the duty to act with care and diligence.

Equity principles require a high standard of loyalty from directors. The standard of loyalty is reflected in a number of positive and negative duties. The positive duties of loyalty include the duty to act *bona fide* and in the best interests of the company.³³ It

³⁰ See Austin et al. *Company Directors* 243; Farrar *Corporate Governance* 100–101; Cassidy *Corporations Law* 200 ff. A duty owed to a company by an executive director employed under a contract of service with the company will arise from an express term in the contract or from an implied term. These general law duties may be supplemented by statutory duties.

³¹ Sections 179(1) and 185 of the Corporations Act of 2001 make it clear that the statutory duties in the Act do not exclude the operation of other laws, including the general law.

³² Du Plessis et al. *Principles of Contemporary Corporate Governance* 258–260 do not even discuss the general law duties in detail. They argue that directors' duties are covered comprehensively and clearly in the statutory provisions. It is therefore unnecessary to rely on case law although the legislation did not intend to codify directors' duties at common law or in equity. Statutory duties form the basis of most litigation on directors' duties in Australia. This issue is dealt with in this discussion on the codification of directors' duties and whether or not there is a significant difference between a partial and comprehensive codification. See ch 5 par 3.1.2.2, where this is discussed in the context of Botswana and New Zealand's company law. See further ch 6 par 5 on the position in South Africa.

³³ This duty is of paramount importance for purposes of this thesis and is discussed in par 3.2.1 below. See *Mills v Mills* (1938) 60 CLR 150 (HC) concerning the scope of the duty to act in good faith. The question of how directors are required to take the interests of the company into account rather than their own interests was discussed. It was held that directors are usually also shareholders in the company of which they are directors. Therefore, in promoting the interests of the company, a director will also promote his own interest. It would be ignoring realities and creating impossibilities in the administration of companies to require that directors should not advert to, or consider, in any way, the

also includes acting with a proper purpose and unfettered discretion. These positive duties are general law duties, but they are also reinforced in the Corporations Act of 2001.³⁴ The negative duties concern those duties requiring directors to avoid conflicts of interest. There are also provisions in the Corporations Act of 2001 dealing with conflicts of interest.³⁵

The enforcement of directors' statutory duties is very important. A breach of these duties gives rise to remedies available to the company in terms of the general law. These remedies include that the company can claim back any profits made by directors as a result of their breach of duty or it can compel directors to rectify their actions in breach of their duties.³⁶ Directors could be in breach of one of their fiduciary duties even if they acted without fault.

The Australian Securities and Investment Commission (ASIC) can also enforce civil penalty provisions. The most important duties of directors are listed as civil penalty provisions. If a breach of any of these provisions is proved, the court will make a declaration of contravention.³⁷ The ASIC³⁸ can then seek a disqualification order, a

effect of a specific transaction on their own interests as shareholders. See also Farrar *Corporate Governance* 104; Baxt et al. *Corporations* 339–342.

³⁴ Section 181 of the Corporations Act 2001; Du Plessis et al. *Principles of Contemporary Corporate Governance* 258–260; Farrar *Corporate Governance* 107. See also the English decision of *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) regarding a “proper purpose”. This case concerned the issue of shares and it was stated that the absence of any self-interest is not enough to make an issue valid. See Baxt et al. *Corporations* 371–378 on this case. See also Klein & Du Plessis “Corporate Donations” 69 on the duty to act with a proper purpose.

³⁵ Section 182, 183 of the Corporations Act 2001.

³⁶ Du Plessis et al. *Principles of Contemporary Corporate Governance* 259.

³⁷ Du Plessis et al. *Principles of Contemporary Corporate Governance* 261.

³⁸ ASIC is a statutory body corporate, consisting of between three and eight members appointed by the Governor-General and nominated by the Commonwealth Attorney-General. Its objects are listed in s 1 of the ASIC Act 51 of 2001 and include:

[T]o provide for the Australian Securities and Investments Commission (ASIC) which will administer such laws of the Commonwealth, a State or a Territory as confer functions and powers under those laws on ASIC; and to provide for ASIC's functions, powers and business; and to establish a Corporations and Markets Advisory Committee to provide informed and expert advice to the Minister about the content, operation and administration of the corporations legislation (other than the excluded provisions), about corporations and about financial products and financial markets; and to establish a Takeovers Panel, a Companies Auditors and

pecuniary penalty order or a compensation order.³⁹ In certain circumstances criminal liability will be incurred.⁴⁰ The main aim of the civil penalty provisions is to highlight the core provisions concerning directors' duties and to serve as a warning tool.⁴¹

The duty to act in good faith in the best interests of the company and for a proper purpose, as well as the duty to avoid conflicts of interest, are civil penalty provisions in terms of the Corporations Act of 2001. The non-fiduciary duty of care and diligence is a general law duty, but is also entrenched in legislation.⁴² The duty of care and diligence is also a civil penalty provision. There are no criminal penalties for a contravention of this duty.⁴³

Other civil penalty provisions relating to directors' duties in the Corporations Act of 2001 include the duty not to use information to gain personally or cause detriment to the corporation,⁴⁴ the duty concerning related party transactions,⁴⁵ the duty relating to share capital transactions,⁴⁶ duties imposed by financial reporting,⁴⁷ the duty to

Liquidators Disciplinary Board, a Financial Reporting Council, an Australian Accounting Standards Board, an Auditing and Assurance Standards Board, a Financial Reporting Panel and a Parliamentary Joint Committee on Corporations and Financial Services.

See Du Plessis et al. *Principles of Contemporary Corporate Governance* 138; Du Plessis "Reverberations After the HIH" 225–245 on ASIC.

³⁹ Du Plessis et al. *Principles of Contemporary Corporate Governance* 261; Austin et al. *Company Directors* at par 9.29 and ch 18.

⁴⁰ Austin et al. *Company Directors* 232; Cassidy *Corporations Law* 229 ff; Redmond *Companies and Securities Law* 377 ff.

⁴¹ Du Plessis et al. *Principles of Contemporary Corporate Governance* 262.

⁴² Section 180(1) of the Corporations Act 2001; Austin et al. *Company Directors* 229; *Permanent Building Society (in liq) v McGee* (1993) 11 ACSR 260 at 287. In the *Permanent* decision it was held that the duty of care and skill should not be equated with or "termed" a "fiduciary duty". It is a duty in law and equity.

⁴³ Austin et al. *Company Directors* 231; Ford et al. *Ford's Principles of Corporations Law* par 8.305; Cassidy *Corporations Law* 210 ff.

⁴⁴ Sections 182 and 183 of the Corporations Act 2001.

⁴⁵ Part 2E and ss 208–229 of the Corporations Act 2001.

⁴⁶ Part 2H and ss 256B, 259A, 259B, 1317(1)(c) of the Corporations Act 2001.

⁴⁷ Parts 2M.2, 2M.3 of the Corporations Act 2001.

prevent insolvent trading,⁴⁸ duties concerning managed investment schemes,⁴⁹ the duty to disclose certain information on a continuous basis,⁵⁰ the duty not to be involved in market misconduct⁵¹ and the duty relating to disclosure for proposed demutualisation.⁵²

Directors' duties are discussed in more detail below with particular emphasis on the duty to act in good faith in the best interests of the company.

⁴⁸ Part 5.7B and s 588G of the Corporations Act 2001.

⁴⁹ Part 5C of the Corporations Act 2001. A managed investment scheme is:

- (a) a scheme that has the following features:
 - (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
 - (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);
 - (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions); or
 - (b) a time-sharing scheme;
- but does not include the following:
- (c) a partnership that has more than 20 members but does not need to be incorporated or formed under an Australian law because of regulations made for the purposes of subsection 115(2);
 - (d) a body corporate (other than a body corporate that operates as a time sharing scheme);
 - (e) a scheme in which all the members are bodies corporate that are related to each other and to the body corporate that promotes the scheme;
 - (f) a franchise;
 - (g) a statutory fund maintained under the Life Insurance Act 1995 ;
 - (h) a regulated superannuation fund, an approved deposit fund, a pooled superannuation trust, or a public sector superannuation scheme, within the meaning of the Superannuation Industry (Supervision) Act 1993 ;
 - (i) a scheme operated by an Australian ADI in the ordinary course of its banking business.

⁵⁰ Part 6CA of the Corporations Act 2001.

⁵¹ Part 7.10 of the Corporations Act 2001. Market misconduct includes market manipulation and false trading and market rigging (to create a false or misleading appearance of active trading).

⁵² Subsection 29(6) of Schedule 4 in the Corporations Act 2001. Some of these duties are discussed in more detail below when discussing specific duties of directors.

3.2 The Fiduciary Duty of Good Faith

Fiduciary relationships exist between persons who stand in a position of trust and power over another and the law requires the former to act in the latter's best interests. The fiduciary duties of a director, in terms of Australian corporations law, include the duty to act in good faith in the best interests of the corporation, not to fetter discretions, to exercise his powers for a proper purpose and to avoid conflicts of interest.⁵³ Most of these general duties have also been embedded in legislation. This is discussed below.

The first fiduciary duty of directors is the duty to act in good faith in the best interests of the company. As stated above, the duty to act in good faith in the best interests of the company is a general law duty. This duty has been affirmed in legislation. Section 181(1) states that directors should act in good faith and in the best interests of the company for a proper purpose.⁵⁴

Fiduciaries are generally subject to higher standards of behaviour than parties involved in arm's length transactions. It is, however, important to know to whom directors owe these duties. In paragraph 3.2.1 below the general Australian interpretation given to the "best interests of the company" is considered.

Directors should also exercise the powers vested in them for a proper purpose. Directors powers must be exercised for the purpose for which they were conferred and in a manner that promotes the interests of the shareholders as a whole.⁵⁵ The bulk

⁵³ Cassidy *Corporations Law* 200–201.

⁵⁴ The second part of s 181(1), namely "for a proper purpose" is discussed below. Although s 181(1) refers to directors acting in good faith and for a proper purpose, these are two separate duties imposed on directors. This is also clear from ss 184(1) and 187 of the Corporations Act 2001 which treat them as two separate duties. See, generally, Austin et al. *Company Directors* 266, 271; Ford et al. *Ford's Principles of Corporations Law* par 8.065; Baxt et al. *Corporations* 337–361. See, for instance, *Mills v Mills* at 162–163 concerning the duty of directors to act in good faith, especially when the directors are also shareholders (see further Baxt et al. *Corporations* 339–342 on this case); *Hospital Products Ltd v Unites States Surgical Corporation* (1984) 156 CLR 41 (HC) at 69 and *News Ltd v Australian Rugby League Ltd* (1996) 21 ACSR 635 stating, *inter alia*, that directors have certain legal discretions and they should use those discretions honestly.

⁵⁵ *Australian Metropolitan Life Assurance v Ure* (1923) 33 CLR 199 at 217; *Mills v Mills* (1938) 60 CLR 150 at 169; Cassidy *Corporation Law* 212.

of cases where it had to be decided whether a director had used his powers for a proper purpose or not were either in the context of a takeover or where there was a contest for corporate control, usually associated with the issue or failure to issue shares.⁵⁶ This is a general law duty, but it has also been entrenched in Australian legislation.⁵⁷ As was stated above, although section 181(1) refers to directors acting in good faith and for a proper purpose, this amounts to two separate duties. The “proper purpose” duty applies to officers of organisations generally. The principles applicable when directors act for an improper purpose are provided in the decision of *Permanent Building Society (in liq) v Wheeler*.⁵⁸ In this case the court found that there was a strong inference that at least some of the directors entered the company into a sale agreement for an improper purpose, namely to persuade a prospective bidder to proceed with the purchase of a related company. The directors therefore used their positions as directors to gain advantages that would cause harm to the company. These principles, applicable when determining whether a director is acting for an improper purpose, include that fiduciary powers granted to directors should be exercised for the purpose for which they were given. It must be shown that the substantial purpose of the directors were improper or collateral to their duties as directors. The issue is therefore not whether their business decisions were good or bad, but rather whether the directors had acted in terms of their fiduciary duties. Honest behaviour does not prevent a finding of improper conduct.⁵⁹ The court must determine whether, but for the improper purpose, the directors would have performed the acts in dispute.⁶⁰ The onus of showing that a director acted for an improper

⁵⁶ *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 (HCA); *Darvall v North Sydney Brick and Tile Co* (1988) 6 ACLC 154.

⁵⁷ Section 181(1) of the Corporations Act 2001. See, generally, Austin et al. *Company Directors* 288–289; Baxt et al. *Corporations* 365–383.

⁵⁸ (1994) 14 ACSR 109 at 137. The claim on the ground of a breach of duty based on improper purpose failed. The breach in this case was, as claimed in the alternative, for the duty to act with reasonable care, skill and diligence. See Baxt et al. *Corporations* 447; Redmond *Companies and Securities Law* 392–401.

⁵⁹ *Emlen Pty Ltd v St Barbara Mines Ltd* (1997) 24 ACSR 303 at 306. However, in *Darvall v North Sydney Brick and Tile Co* 154 the court suggested that the validity of an exercise of power depends on whether the directors were doing what they honestly believed to be in the best interests of the company.

⁶⁰ Austin et al. *Company Directors* 289; Cassidy *Corporations Law* 212ff. In the English case of *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) it was held that it is the “substantial purpose” for which the power is exercised that must be analysed to determine whether the power was

purpose rests on the person asserting the misuse.⁶¹ In determining whether a director acted for an improper purpose, the court will first ascertain, as a matter of law, the purposes for which the power may, and may not, be exercised and then determine, as a matter of fact, the purpose for which the power was exercised.⁶²

Directors are, furthermore, bound to act for the company and their decision making authority cannot be limited to provide for another's interest.⁶³ Directors cannot agree to exercise their discretion in a particular manner⁶⁴ or act blindly at the discretion of others.⁶⁵

Directors are also subject to the fiduciary duty not to have conflicting interests between their personal interests and those of the company. This duty is part of the general duty that directors should act in good faith and in the best interests of the company. This duty prevents directors from contracting with the company without making full and proper disclosure of their interests in the contract.⁶⁶ Directors should avoid conflicts of interest, especially where such conflict concerns the personal

improperly used or not. If there is more than one purpose, whether there is a breach or not, will depend on which factor was the "trigger" for the director's actions: *Darvall v North Sydney Brick and Tile Co* at 154; *Emlen Pty Ltd v St Barbara Mines Ltd* at 307.

⁶¹ *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199 (HC) at 206 and 219 (the directors, in exercising their discretion, refused to register a transfer of shares); *Ascot Investments Pty Ltd v Harper* (1981) 148 CLR 337 (HC) at 348. See also Austin et al. *Company Directors* 289.

⁶² Austin et al. *Company Directors* 293–294.

⁶³ Austin et al. *Company Directors* 228; Cassidy *Corporations Law* 211 ff. This duty is not specifically entrenched in legislation.

⁶⁴ *Davidson v Smith* (1989) 15 ACLR 732; *Fulham Football Club v Cabra Estates plc* [1992] BCC 863.

⁶⁵ Austin et al. *Company Directors* 259–261. See the English decision of *Russell v Northern Bank Development Corp Ltd* [1992] BCLC 1016 (HL) concerning the duty to retain discretions (a company cannot fetter its statutory power to increase capital by entering into an indefinite undertaking to do so). See also *Thorby v Goldberg* (1964) 112 CLR 597 (HCA) at 605–606 where it was held that directors can still contract to exercise their powers in future in a particular manner, provided that, in deciding to make the contract, they give proper consideration to the desirability of entering into the contract and they decide to do so in the best interests of the company as a whole.

⁶⁶ Cassidy *Corporations Law* 218. This duty extends to avoid being placed in a position where such a conflict is even possible: *Chan v Zacharia* (1984) 154 CLR 178 at 199; *Hospital Products Ltd v Unites States Surgical Corporation* (1984) 156 CLR 41 (HC) at 103; and the English decision of *Boardman v Phipps* [1967] 2 AC 46 (HL).

exploitation of opportunities or where the directors benefit someone other than the company by way of their actions.⁶⁷ Austin distinguishes between five closely related and largely overlapping equity rules that apply to conflicts of interest by company directors and senior officers. These five fiduciary rules are: (1) the conflicts of interest rule, (2) the conflict of duties rule, (3) the misappropriation rule, (4) the no-profit rule and (5) the business opportunity rule. The conflicts of interest rule states that a director may not have an interest that conflicts with his duty to the company, except with the company's fully informed consent.⁶⁸ The conflict of duties rule provides that a director may not have an inconsistent engagement with a third party (such as being a director of another company), except if the company is fully aware thereof.⁶⁹ According to the misappropriation rule, a director must not misappropriate the company's property for personal or a third party's benefit.⁷⁰ The no-profit rule states that a director should not misuse his or her position for personal or a third party's possible advantage. He should account to the company for any gain made due to the fiduciary office.⁷¹ Lastly, the business opportunity rule holds that a director should not divert any profit-making opportunity in the same line of business as the company's present or prospective business, unless with the full consent of the company.⁷²

⁶⁷ See Baxt et al. *Corporations* 384–412; Cassidy *Corporations Law* 217 ff; Redmond *Companies and Securities Law* 418ff for a discussion of this duty and relevant case law interpreting it.

⁶⁸ The director's interest may even be small, he may only be one of many shareholders with an interest in the contracting company: *Transvaal Lands Co v New Belgium Land and Development Co* [1914] 2 Ch 488. See also *Capital Investments Corporations Pty Ltd v Classic Trading Pty Ltd* (unreported Federal Court, 28 September 2001) in which it was held that a director's diversion of a business opportunity to another company, associated with the director, was a breach of the director's fiduciary duty to the company. See Baxt et al. *Corporations* 385.

⁶⁹ See Austin et al. *Company Directors* 313. In some cases disclosure is not enough, and the director of both competing companies may be obliged to abstain from taking part in negotiations or voting on the specific transaction: see *Jenkins v Enterprise Gold Mines NL* (1992) 6 ACSR 539.

⁷⁰ *Paul A Davies (Australia) Pty Ltd v Davies & Sons* (1984) 8 ACLR 1; *Furs Ltd v Tomkies* (1936) 54 CLR 583.

⁷¹ See *Warman International Ltd v Dwyer* (1995) 69 ALJR 362 for a discussion on how to calculate the profits for which a director might be accountable.

⁷² As discussed in Austin et al. *Company Directors* 313. See also Austin et al. *Company Directors* 326–334 for a discussion of the conflicts of interest rule and 335–341 for a discussion of the conflict of duties rule. See *George Bray v John Rawlinson Ford* [1896] AC 44 (HL) at 51 where the court found that a director is not allowed to put himself in a position where his interests conflict with those of the company. See further *Permanent Building Society (in liq) v McGee* 260 where it was held to merely disclose the conflict and to abstain from voting on the proposal at the relevant board meeting was

The fiduciary duty of a director to avoid conflicts of interest has also been supplemented with statutory provisions. Sections 191–196 of the Corporations Act of 2001 deal with disclosure of material personal interests and voting of interested directors.⁷³ Sections 182 and 183 determine that directors should not use their position or information they obtain improperly to gain personally or for the benefit of a third party.⁷⁴

3.2.1 The Traditional Position: Directors’ Duties Owed to Whom?

A director must act *bona fide* in the best interests of the company. The first issue to consider is whether there is a difference between stating that a director should act in “the interests of the company” compared to the “*best* interests of the company”. The question that arises is whether the inclusion of the word “best” implies that directors’ decisions should be exercised in such a way that it is best for the company. This would indicate that directors should consider all options and choose the best possible one.⁷⁵ Ford⁷⁶ submits that there is no significant difference between the two phrases. Directors’ decisions are not required to be the best possible for the company, but directors are required to act in the interests of the company. In some cases the two

insufficient in the specific circumstances. See also *R v Byrnes, R v Hopwood* (1995) 17 ACSR 551, discussed by Baxt et al. *Corporations* 404–412, where it was held that a duty not to allow a conflict will operate both at common law and under the Corporations Act of 2001.

⁷³ The provisions include “*de facto*” and “shadow” directors, but not non-executive directors: see s 9 of the Corporations Act 2001. See also Austin et al. *Company Directors* 317; Farrar *Corporate Governance* 110–111. Section 192 provides that a director should give notice about a material interest: see *Boardman v Phipps* at 124 on the real possibility of a conflicting interest and not some theoretical or rhetorical conflict. It was further stated that a person who is in a fiduciary position is not, unless expressly provided, entitled to profit from that position. Where he does make a profit, based on his position as fiduciary, he must account for it (at 123).

⁷⁴ These sections apply to directors, officers and employees of the corporation. A “corporation” includes any body corporate, see s 57A of the Corporations Act 2001. Section 182 also applies to secretaries. See s 9 of the Corporations Act 2001. See Austin et al. *Company Directors* 317–318; Du Plessis et al. *Principles of Contemporary Corporate Governance* 264; Cassidy *Corporations Law* 228 ff.

⁷⁵ The issue of the inclusion of the word “best” was also considered by Klein & Du Plessis “Corporate Donations” 85. They argue that the Corporations Act 2001 refers to “best interests” suggesting that directors should consider all possible alternatives, and choose the best one. They argue, however, that this does not appear to be the requirement imposed by the courts, referring to *Charterbridge Corporation Ltd v Lloyds Bank Ltd* (1970) Ch 62 at 75.

⁷⁶ Ford et al. *Ford’s Principles on Corporations Law* par 8.065.

phrases are used interchangeably, indicating that there is no significant difference between them.⁷⁷

Second, it is necessary to understand what is meant by “the company”.⁷⁸ In some cases it has been stated that directors should act in the best interests of the company, whereas other cases use the term “the company as a whole”.⁷⁹ The Corporations Act of 2001 only refers to “the company”. The general or traditional viewpoint is that directors owe their duties to the company and that no independent duties are owed to any third parties.⁸⁰ It seems that the words “the company” do not indicate that directors should act in the best interests of the company as a separate legal entity, but rather that they should act in the best interests of the members collectively.⁸¹

⁷⁷ See, for example, *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 (HCA) at 293. In this case it was specifically held that directors of a company cannot ordinarily exercise a fiduciary power to allot shares for the purpose of defeating the voting powers of existing shareholders by creating a new majority. For a discussion of this case, see Baxt et al. *Corporations* 378–382.

⁷⁸ In the English case of *In Re Smith & Fawcett Ltd* [1942] 1 Ch 304 (CA) at 306 it was held that directors must do what they honestly believe is in the best interests of the company. The court cannot substitute the directors’ view on what is best for the company with their own view. See generally Ford et al. *Ford’s Principles on Corporations Law* par 8.065; Cassidy *Corporations Law* 201.

⁷⁹ See *Greenhalgh v Arderne Cinemas* [1951] Ch 286 at 291 and *Darvall v North Sydney Brick and Tile Co* at 154, where it was held that directors should not just consider existing shareholders when managing a company, but also future shareholders.

⁸⁰ Berkahn “Directors Duties” 367 refers to the traditional viewpoint when discussing directors’ duties to creditors. See also Austin et al. *Company Directors* 274–276; Du Plessis et al. *Principles of Contemporary Corporate Governance* ch 2; Baxt et al. *Corporations* 343–344; Langton & Trotman “The Best Interests of the Corporation” 164 on the traditional meaning of “the company” referring to the shareholders collectively. See also *Australian Innovation Ltd v Petrovsky* (1996) 21 ACSR 218 at 222 stating that the duty is owed to the company, to the exclusion of the shareholders. Recent cases, especially in New South Wales, suggest that when one is dealing with a company with wider public interests, the interests of stakeholders may be significant. In both *NRMA v Geeson* (2001) 39 ACSR 401 and *NRMA v Geeson* (2001) 40 ACSR 1 it has been suggested that in an organisation such as NRMA (an insurance company in Australia) there may be a “public duty” on the part of directors to disclose information concerning the activities of the board to the public via the press. In *Geneva Finance Ltd (rec and mgr apptd) v Resources Industries Ltd* (2002) ACLC 1427 it was held that the *dicta* of the above-mentioned cases do not constitute a positive duty on the part of directors to consider the interests of certain stakeholders.

⁸¹ See *Ngurli v McCann* (1953) 90 CLR 425 at 438 (HCA). In this case the directors benefited one group of shareholders at the expense of the other shareholders. See also Ford et al. *Ford’s Principles on Corporations Law* par 8.095; Dawson “Acting in the Best Interest of the Company” 78. See *Teck Corporation Ltd v Millar* (1973) 33 DLR at 288 (a director’s duty is to the company, the company’s shareholders are the company and therefore no interests outside of those of the shareholders can be considered by the directors). See, however, *People’s Department Stores Inc v Wise* (2004) 244 DLR at 564 (in determining whether directors acted in the best interests of the corporation it may be legitimate to consider the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment). See ch 2 par 5.2 on the proposed theory of the company as a separate legal entity.

In the next section the protection afforded specific stakeholders is considered.⁸² The position of shareholders, creditors, employees and consumers are dealt with. The various corporate governance initiatives in Australia are also referred to in order to determine how different stakeholders are treated.

3.2.2 Individual Shareholders

Directors do not have a direct fiduciary duty towards individual shareholders.⁸³ Their duty is to the company in the absence of special facts giving rise to a fiduciary relationship with particular shareholders.⁸⁴

It has been suggested⁸⁵ that directors should consider the interests of existing members in certain circumstances due to the fact that they have risked their capital in the hope of gain. Mallin treats shareholders differently from other stakeholders, and argues that shareholders invested their money to provide risk capital to the company and that their rights are enshrined in law, whereas those of other interest groups are

⁸² These different interest groups are also considered in the review of the South African law. Much of the case law referred to in this chapter is also discussed in chapter 6 (especially regarding creditors, see ch 6 par 3.2). In *New World Alliance (Pty) Ltd; Sycotex (Pty) Ltd v Baseler* (1994) 51 FCR 425; *Fitzroy Football Club Ltd v Bondborough Pty Ltd* (1997) 15 ACLC 638 it was confirmed that directors' fiduciary duties are owed to the company and not a specific stakeholder. See also Lumsden & Fridman "Corporate Social Responsibility" 173 on the protection afforded to stakeholders in Australia.

⁸³ See, however, *Brunninghausen v Glavanics* (1999) 17 ACLC 1247 at 1254 where the court held that directors should consider the interests of individual shareholders. In this case a company had two directors who were also the only shareholders. The one director sold his shares to the other. The buyer had negotiations with another third party and received an offer from him. The court held that a director has a fiduciary duty towards a shareholder and that the director who had purchased the shares should have disclosed the negotiations to the seller. This decision highlights the willingness of the courts to adopt a commercial approach in closely held companies, but it does not contemplate a separate duty to shareholders. The decision is rather based on the specific facts of the case: see Baxt et al. *Corporations* 351–355. In *Mesenberg v Cord Industrial Recruiters Pty Ltd* (1996) ACLC 519 it was held that in a "two person" company a director's duties are owed to the other shareholder/director as much as to the company.

⁸⁴ Farrar *Corporate Governance* 106; Ford et al. *Ford's Principles on Corporations Law* par 8.095 argues that "the interests of the company" include considering the interests of existing members and even future members. I suggest that it is preferable to indicate that directors should have regard to long-term benefits, which would include those of the future members. See also *Provident International Corporation v International Leasing Corp Ltd* [1969] 1 NSW 424 at 440 suggesting that directors should consider the interests of future and existing members. See Austin et al. *Company Directors* at par 7.8 on this case.

⁸⁵ Austin et al. *Company Directors* 275.

not.⁸⁶ She further suggests that shareholders are recipients of the residual free cash flow. Shareholders have a vested interest in trying to ensure that resources are used to maximum effect, but this should also be to the benefit of society as a whole.⁸⁷

3.2.3 Creditors

Some Australian cases suggest that directors have an indirect duty to consider the interests of creditors when managing a company in circumstances where the company is nearing insolvency.⁸⁸

In *Walker v Wimborne*⁸⁹ Justice Mason held: “It should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company.”⁹⁰ The decision in *Walker v Wimborne* was cited with approval by the Supreme Court of New South Wales in *Ring v Sutton*.⁹¹ In *Ring v Sutton* it was stated that directors should consider the interests of creditors when exercising their fiduciary duties to the company. In *Kinsela v Russell Kinsela (Pty) Ltd (in liq)*⁹² it was held that directors can consider the interests of creditors when a company is solvent, but as part of their duty to the company. When a company is insolvent or nearing insolvency, the creditors’ interests displace those of the shareholders collectively and directors must

⁸⁶ Mallin *Corporate Governance* referred to in Du Plessis et al. *Principles of Contemporary Corporate Governance* 19.

⁸⁷ Mallin *Corporate Governance* referred to in Du Plessis et al. *Principles of Contemporary Corporate Governance* 19.

⁸⁸ Austin et al. *Company Directors* 276; Baxt et al. *Corporations* 344–351; Cassidy *Corporations Law* 204–207. See also ch 6 par 3.2.

⁸⁹ (1976) 137 CLR 1 (HC) at 449.

⁹⁰ Emphasis added. See Lombard *Directors’ Duties to Creditors* 116; Havenga *Fiduciary Duties of Company Directors* 32–42; Finch “Directors’ Duties Towards Creditors” 23–24; Fourie “Die Plig van Direkteure Teenoor Maatskappyskuldeisers” 28–40 for a discussion of this case.

⁹¹ (1980) 5 ACLR 546 at 550. See also the English decision of *Kuwait Asia Bank EC v National Mutual Nominees Ltd* (1991) 1 AC 187 where it was held that a director does not by reason only of his position as director owe any duty to creditors. It was, however, stated that although directors are not liable as such to creditors, a director may in terms of an agreement assume a special duty to a creditor of a company.

⁹² (1986) 10 ACLR 395 at 401.

have regard to creditors' interests. In *New World Alliance (Pty) Ltd; Sycotex (Pty) Ltd v Baseler*⁹³ the court rejected the possibility that directors can have a direct duty to consider the interests of creditors. In *Spies v The Queen*⁹⁴ it was clearly stated that directors' duties are not owed directly to creditors.⁹⁵

In sharp contrast to these cases, other cases in Australia and England interpreted the *dicta* in the *Walker* decision as pointing to a direct duty, and not an indirect duty as discussed above.⁹⁶ The statement of Lord Templeman in the English case of *Winkworth v Edward Barron Development Co Ltd*⁹⁷ can be understood as providing support for a direct duty. His Lordship held: "A duty is owed by the directors *to the company and to the creditors* of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves, to the prejudice of the creditors."⁹⁸ This statement was confirmed in the Australian decision of *Jeffree v National Companies and Securities Commission*.⁹⁹ But it has been argued that the *Winkworth* decision is not compelling evidence for a direct duty towards creditors because Lord Templeman only made the remark *obiter*.¹⁰⁰ The *West Mercia Safetywear Ltd (in liq) v Dodd*¹⁰¹

⁹³ (1994) 51 FCR 425 at 550.

⁹⁴ (2000) 201 CLR 603 (HC).

⁹⁵ At 635. See Hargovan "Directors' Duties to Creditors" 390–409 for a detailed discussion of the *Spies* decision. In New Zealand the court in *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) also held that the duties of directors are owed to the company.

⁹⁶ See ch 3 par 3.1.3 for the English cases.

⁹⁷ [1987] 1 All ER 114 (HL) at 118. See also ch 3 par 3.1.3 on this case.

⁹⁸ Emphasis added. See also Keay "The Duty to Creditors" 384; Hargovan "Directors' Duties to Creditors" 394; Fourie "Die Plig van Direkteure Teenoor Maatskappyskuldeisers" 35; Wishart "Models and Theories" 326.

⁹⁹ (1989) 15 ACLC 217 at 228. In *Grove v Flavel* (1986) 11 ACLR 161 a separate direct duty to creditors was also suggested.

¹⁰⁰ Sealy "Directors' Wider Responsibilities" 177; Riley "Directors' Duties and the Interests of Creditors" 89; Fourie, Havenga and Lombard agree: Lombard *Directors' Duties to Creditors* 118; Havenga *Fiduciary Duties of Company Directors* 40; Fourie "Die Plig van Direkteure Teenoor Maatskappyskuldeisers" 37. In *Spies v the Queen* at 636–637 it was said that it is doubtful whether Mason J intended to suggest that directors owe an independent duty directly to creditors. See also *Yukong Lines Ltd of Korea v Rendsburg Investments Corporation (No 2)* (1998) 1 WLR 294 where Toulson J rejected the notion of a direct duty being owed to creditors.

decision imported the principles of *Walker v Wimborne*, *Nicholson v Permakraft (NZ) Ltd* and *Kinsela v Russel Kinsela Pty Ltd (in liq)*¹⁰² into the English law. The *West Mercia* decision confirmed that company directors owe duties to creditors, but that they should be exercised when directors act in the best interests of the company as a whole. This decision therefore extends the meaning of the “interests of the company” by including the interests of creditors, but on an indirect basis. The interests of the company as a whole are still of paramount importance. A separate duty to creditors is therefore not recognised in this decision.¹⁰³

It is clear that most of the Australian decisions still view the company as the ultimate beneficiary of directors’ fiduciary duties, thus applying the indirect duty.¹⁰⁴ This is especially so after the *Spies v The Queen* decision where it was clearly held that directors’ duties are owed to the company and not directly to the creditors. The interests of creditors would therefore receive priority in certain instances, even if this consideration can be to the detriment of the shareholders. The rationale for this lies in the fact that the company is effectively trading with the creditors’ money when the company is in financial distress.¹⁰⁵ The cases do not provide clear guidelines as to when such a duty would arise.

Section 588G¹⁰⁶ of the Corporations Act 2001 also imposes a duty on directors to prevent the company from trading whilst insolvent and a corresponding duty to prevent their subsidiaries from engaging in such conduct.¹⁰⁷

¹⁰¹ [1988] BCLC 250 (CA). See ch 3 par 3.1.3 on this case.

¹⁰² (1986) 10 ACLR 395.

¹⁰³ See ch 3 par 3.1.3 on this English decision. See further Finch “Directors’ Duties Towards Creditors” 23–24 for a discussion of the *West Mercia* decision. See generally, Keay “Interests of Company Creditors: When is it Triggered?” 315 for a discussion of the case law focusing on a direct and indirect duty towards creditors.

¹⁰⁴ Keay “Interests of Company Creditors: When is it Triggered?” 316.

¹⁰⁵ Keay “The Duty to Creditors” 385–386.

¹⁰⁶ Previously s 592.

¹⁰⁷ The new Corporations Law Amendment (Employees Entitlements) Act 2000 extended this provision that employees are also treated as creditors (see par 3.2.4.1 (c) below).

Paper 3 of CLERP refers to the position of creditors when discussing the general law duties of directors. It provides that directors should manage the company in the best interests of the corporation. It is specifically stated that the courts developed this duty further to require directors to consider the interests of creditors in certain circumstances, especially when the company is nearing insolvency.¹⁰⁸

The issue of how creditors' interests should be protected is therefore complex and questions such as: should this duty towards creditors be an indirect or a direct one, who should be the beneficiary of the duty and when should the duty arise, create difficulties. These questions are further discussed in chapter 6¹⁰⁹ and these Australian cases are referred to. New Zealand and English case law is also considered. These cases are referred to in the South African chapter in order to answer the questions raised above. There is no South African case law on directors' duties to creditors.

3.2.4 Employees

It was stated before that directors should treat the interests of shareholders as paramount when managing a company.¹¹⁰ They can consider the interests of other groups, but only when this will be in the interests of the company or prescribed in terms of other legislation like labour laws.

There is some overlap in the fields of labour law and corporate law, and a separation between these two fields is neither desirable nor sustainable. Employees have a number of interests in a corporation, such as job security, pleasant working conditions, remuneration and the provision of pension benefits. In essence,

¹⁰⁸ At p 16. The document refers to *Walker v Wimborne* and *Kuwait Asia Bank v National Mutual Nominees Ltd* (1991) 1 AC 187 concerning directors' duties to creditors. See the discussion below on the *ASX's Best Practice Principles and Recommendations* where the original principle 10 relates to the recognition of the legitimate interests of stakeholders (including creditors). These recommendations were reviewed during 2007 (see discussion below in par 4.1).

¹⁰⁹ Paragraph 3.2.

¹¹⁰ As was seen in the above discussion, the traditional viewpoint in Australia is that directors owe their duties to the company as a whole, being the shareholders collectively. See Mitchell et al. "Shareholder Value and Employee Interests" 432.

employees are concerned with the running of the corporation they work for because their livelihood depends on it.¹¹¹

In the “outside” or shareholder model, which is applicable in Australia, the United Kingdom and South Africa, employees do not have a dominant role in the day-to-day management of the corporation.¹¹² The position in other countries, such as Germany, is very different and employees play a much more active role with representation on board level.¹¹³ The link between the specific model of corporate governance and the extent of its reliance on the increase of shareholder value and the protection of employees is very important. Increasing shareholder value may lead to a deterioration of the position of employees. It was argued that stakeholders (such as employees) are usually in a more favourable position when the stakeholder model is followed.¹¹⁴ Because of this possible deterioration, some Australian companies provide employees with share option schemes to protect them in a limited way, because the better the

¹¹¹ Du Plessis et al. *Principles of Contemporary Corporate Governance* 19–22. See also See Baxt et al. *Corporations* 355–361 on the position of employees.

¹¹² In terms of the shareholder theory, the maximisation of shareholder wealth is of the utmost importance. This theory is sometimes referred to as the “*nexus* of contracts” or “agency theory”. There are, however, a few differences between the shareholder theory and the *nexus* of contracts or agency theory. In terms of the latter theory, shareholders are only one of many groups that have contractual claims against the corporation. This theory recognises a division between ownership and control. The main disadvantage of this model is the fact that directors may act in their own interests instead of those of the company, at the expense of the shareholders. However, shareholders have a number of remedies at their disposal to prevent such conflicts of interest. They have voting rights when important corporate issues such as the appointment and removal of directors are at issue. But shareholders are usually quite inactive and do not necessarily vote or enforce directors’ duties. In terms of this model, employees do not have board representation. See ch 6 par 3.3 where the unitary board structure is discussed. The link between the applicable board structure and stakeholder protection is also discussed. See ch 2 pars 3, 4 on the theories and models of corporate governance.

¹¹³ See ch 6 par 3.3.2.1 for a detailed discussion of the two-tier board system and co-determination applicable in Germany. The protection that a specific country affords its employees is closely linked to the model of corporate governance it follows (see ch 2 par 3 for a discussion of the different theories of corporate governance). In Germany, for instance, a long-term orientation is followed, which is to the advantage of employees. Directors do not solely base their decisions on financial factors, but also consider the interests of employees. In the United Kingdom, where employees do not have the same level of participation as in Germany, short-term interests play a significant role when directors take decisions. Directors will consider the interests of other stakeholders (such as employees), but wealth maximisation is their ultimate aim. See s 172(1) of the United Kingdom Companies Act of 2006 (discussed in ch 3 par 4.3.3 above). See further Mitchell et al. “Shareholder Value and Employee Interests” 419–420.

¹¹⁴ See ch 2 par 3 above. It is, however, the co-determination element of the two-tier board structure that provides employees with protection and not the specific board structure.

company does, the better the employees (holding shares) will do.¹¹⁵ There is also separate legislation in Australia protecting the rights of employees.¹¹⁶

A number of corporate governance reports¹¹⁷ also deal with the protection of employees. The specific legislation protecting employees as well as the reports dealing with this issue are discussed and evaluated below. A conclusion is then drawn on whether or not employees are sufficiently protected in Australia.

3.2.4.1 Specific Labour Legislation

Despite the fact that Australian corporate law favours shareholder primacy, directors are obviously still subject to specific labour law legislation.¹¹⁸ In this section the effectiveness of employment contracts, compulsory arbitration and conciliation, and legislation protecting the rights of employees are considered.

a) Employment Contracts

Employees are protected in employment contracts. This gives employees a degree of certainty as to their rights. Mitchell et al. suggest that if one sees employment contracts as a “wages-for-work” bargain, then they are certain and complete. A list of tasks and time periods is provided in the contract followed by a description of the relevant benefits. Employees are, however, usually uncertain, at the time of concluding the contract, of what is exactly expected of them. Employment contracts are sometimes incomplete regarding the specifications of a specific job.¹¹⁹ Many of the terms of employment contracts are only specified in the course of the relationship

¹¹⁵ Reynolds “Employee Stakeholder Interests” 95–108. The object of employee share option schemes is usually to achieve financial participation rather than participation in decision making (at 104). The employees who hold shares in a company usually have short-term financial goals, rather than to act in the best interests of employees generally and over the long-term.

¹¹⁶ For example, the Workplace Relations Act 86 of 1996. See the discussion in par (c) below on separate legislation protecting employees.

¹¹⁷ For example, the *ASX’s Best Practice Principles and Recommendations*; the *Corporate Responsibility Report* of June 2006 and the *HIH Report*.

¹¹⁸ Paragraph 3.2.1 above.

¹¹⁹ Deakin & Morris *Labour Law* 238.

between the employee and employer.¹²⁰ Employees' expectations are directly linked to the success of the specific organisation. This is an interest that cannot be protected by way of a contract. Thus, an issue such as job security cannot be protected by way of a contract, but is rather dependent upon day-to-day decisions made by the employers or management.¹²¹ Much of labour law is a response to the employment relationship and not a continually re-negotiated contact between equal parties.¹²²

b) Conciliation and Arbitration

During most of the twentieth century the federal regulation of labour law in Australia was governed by the conciliation and arbitration power in the Federal Constitution.¹²³ The federal government had the power to make laws in respect of conciliation and arbitration for the settling of interstate industrial disputes. The Australian Industrial Relations Commission (AIRC) had, until 2006, the exclusive power to settle such disputes.¹²⁴ This system of compulsory arbitration consisted of independent, quasi-judicial tribunals that arbitrated or certified legally binding awards. Awards defined a range of minimum standards including wage rates, overtime, standard hours and leave entitlements. Awards were usually multi-employer in kind, resulting in the wages being centralised and uniform across the different industries.¹²⁵ Australia therefore had a centralised wage-fixing system. The awards determined by AIRC were binding on the parties. It was quite easy to terminate an employees' employment as only a week's notice was required. In 1984 awards started to include

¹²⁰ Many of the terms of an employment relationship in Anglo-Australian law grew not out of the private law of contract, but from penal masters and servants legislation of the nineteenth century. See Working Paper No 203: *The Contract of Employment* issued by the Centre for Business Research, University of Cambridge and written by Deakin; Mitchell et al. "Shareholder Value and Employee Interests" 460.

¹²¹ Mitchell et al. "Shareholder Value and Employee Interests" 460–461.

¹²² Davies & Freedland *Kahn-Freund Labour and the Law* 18; Mitchell et al. "Shareholder Value and Employee Interests" 460.

¹²³ See s 51(35) of the Federal Constitution. See Wooden "Industrial Relations Reform" 243 (Industrial tribunals and commissions in determining wages and conditions had been in place for over 70 years in Australia.)

¹²⁴ See generally on compulsory arbitration in Australia: Macintyre & Mitchell *Foundations of Arbitration*.

¹²⁵ Wooden "Industrial Relations Reform" 244 (Australian employees were heavily dependant on highly prescriptive multi-employer awards.)

national standards of redundancy and provisions on unfair dismissals. These standards included that when an employer made material changes concerning production, structure or technology that would probably have an effect on employees, such as dismissals, transfers or restructuring, they first needed to consult with the employees. This was, however, only a procedural obligation on employers as this consultation with employees was only required at the implementation stage of the possible dismissal, restructuring or transfer. It would therefore be an overstatement to say that this consultation process limited employers' rights. Employers could still act in a manner that was in the best interests of the shareholders and to the detriment of the employees.¹²⁶

In the late 1980s and the early 1990s it was realised that in order for Australia to compete globally, parties should have the ability to negotiate more flexible working arrangements. The centralised fixation of wages and conditions of employment was replaced with an enterprise-based employment system.¹²⁷ In 1993 collective bargaining was also introduced at enterprise level, without the Commission's involvement.¹²⁸ Today parties can negotiate their terms and conditions of employment at enterprise level.¹²⁹

c) Legislation

The Workplace Relations Act of 1996¹³⁰ brought about a paradigm shift in the nature of employment regulation in Australia.¹³¹ This Act was the principal statute, at

¹²⁶ Mitchell et al. "Shareholder Value and Employee Interests" 462–467.

¹²⁷ These amendments were incorporated into the Industrial Relations Act of 1988 (Cth) in 1992 (see Cairncross & Buultjens "Enterprise Bargaining" 475). An enterprise-based employment system relates to bargaining between parties in single/specific enterprises and not across the whole industry in Australia. The terms and conditions of Australia's workforce are today generally determined without the intervention of a third party. See also Dabscheck "The Slow and Agonising Death of the Australian Experiment with Conciliation and Arbitration" 277.

¹²⁸ See the Industrial Relations Reform Act 1993 (Cth). See Macdonald, Campbell & Burgess "Ten Years of Enterprise Bargaining" 1.

¹²⁹ Mitchell et al. "Shareholder Value and Employee Interests" 462–467.

¹³⁰ Act 86 of 1988 as amended in 1996.

¹³¹ Mitchell et al. "Shareholder Value and Employee Interests" 462.

federal level, that dealt with the protection of employees' rights.¹³² The objects of this Act were to encourage employment regulation that is in line with productivity, flexibility and international competitiveness.¹³³ It regulated workplace conditions, wage-setting arrangements, conciliation and arbitration of workplace disputes regarding pay and working conditions.¹³⁴ In terms of this Act, consultation was required with employees at a workplace level. Traditionally, the main instrument regulating the working conditions of employees was by way of an award, as discussed above. Awards now have less influence and are only allowed in certain industries.¹³⁵ The Act requires negotiation at workplace level if employees want to supplement their award conditions. It introduced a number of enterprise-based agreements to facilitate negotiations at workplace level.¹³⁶ These agreements were used to supplement award conditions or to derogate from the minimum standards, subject to the fact that the agreements may not be to the disadvantage of the employee.¹³⁷ The Act weakened the position of trade unions. Unions may still seek awards for individual members, but they are of limited value to the members due to individual agreements concluded with the employees and non-union collective agreements.¹³⁸ The Workplace Relations Amendment Act (Work Choices) of 2005¹³⁹ has further weakened the position of employees as the right to strike has practically

¹³² Du Plessis et al. *Principles of Contemporary Corporate Governance* 20. The Workplace Relations Amendment Act (Work Choices) of 2005 replaced the Workplace Relations Act of 1996 in 2005.

¹³³ Section 3(a).

¹³⁴ See, for example, part 2, division 2 and part 12 division 4, subdivision B.

¹³⁵ Section 89A of the Workplace Relations Act.

¹³⁶ Part 8, division 2. These include collective agreements, non-union-based agreements and non-union individualised agreements (referred to as Australian workplace agreements).

¹³⁷ This is referred to as the "no-disadvantage" test. The test requires the regulatory authorities to examine the conditions set down in the enterprise agreement in order to ensure that those conditions do not "disadvantage" the employee when compared with the employee's conditions under previously applying regulatory arrangements. See the *Final Report: Protecting the Worker's Interest in Enterprise Bargaining: The "No Disadvantage" Test in the Australian Federal Industrial Jurisdiction* prepared for the Workplace Innovation Unit, Industrial Relations, Victoria by Mitchell et al. (The Centre for Employment and Labour Relations Law School).

¹³⁸ McCrystal "Shifting the Balance of Power" 193.

¹³⁹ Act 153 of 2005. This Act was assented to on 14 December 2005. The bulk of the legislation came into force on 27 March 2006. This Act replaced the Workplace Relations Act of 1996 entirely.

been abolished. The legislation recognises the right to take industrial action within collective bargaining, but in practice this does not really happen. When engaging in industrial action a balance between the right of workers to engage in such action and the welfare of the general community is needed. In terms of the Workplace Relations Amendment Act (Work Choices) the welfare of the general community weighs stronger than the right to industrial action.¹⁴⁰ This constrains employees' rights to access to collective bargaining and union representation.¹⁴¹

Commentators argue that the shift to enterprise-based regulation and the weakening of trade unions have strengthened the position of management.¹⁴² It would seem that the Work Choices Act enables management to increase shareholder value by cutting labour costs, restructuring the production process and excluding workers from enterprise-level negotiations.¹⁴³

It is submitted that employment contracts and the legislation dealing with employees and their rights do not provide sufficient protection for employees. Employment contracts do not protect employees sufficiently as the contracts are often incomplete. Much of labour law is a response to the labour relationship and not a renegotiated contract between parties. It would seem that employers are favoured by the Workplace Relations Amendment Act (Work Choices) and that it does not create the correct balance between employees and employers.

The Corporations Law Amendment (Employee Entitlements) Act of 2000, however, emphasises the need for directors to consider the interests of employees when managing a company, thereby improving the protection available to employees.¹⁴⁴ In

¹⁴⁰ See McCrystal "Shifting the Balance of Power" 193 for other changes that the Work Choices Act brought about that has shifted the balance of power in collective bargaining in favour of employers.

¹⁴¹ Bottomley & Forsyth "Corporate Law" 20.

¹⁴² Mitchell et al. "Shareholder Value and Employee Interests" 470; McCrystal "Shifting the Balance of Power" 193.

¹⁴³ As argued in Mitchell et al. "Shareholder Value and Employee Interests" 470.

¹⁴⁴ Senator Campbell said (10 May 2000) that these amendments were seen as a "very important initiative which will supply real, deliverable support to employees, support that they can touch and feel".

terms of this Act part 5.8A was incorporated into the Corporations Act of 2001.¹⁴⁵ Part 5.8A introduces a new duty and offence into the Corporations Act to penalise persons¹⁴⁶ who intentionally enter into agreements or transactions with the purpose of preventing or significantly reducing the recovery of entitlements¹⁴⁷ by employees. The court has the power to order such persons to compensate the company's employees. The object of this part of the Act is to protect the entitlements of a company's employees from agreements or transactions that are entered into with the intention of defeating the recovery of those entitlements.

It is not clear how employees will enforce these rights.¹⁴⁸ It is very difficult to prove that directors were acting with the requisite intention under these provisions, namely "inevitably [to] limit [their] scope and effectiveness as a protective mechanism for employees". Employees will have to show that their entitlements are "missing" and that the directors (or other persons) entered into arrangements with the purpose of ensuring that their entitlements will not be available.¹⁴⁹ This Act still needs to be tested in court.¹⁵⁰

3.2.4.2 *Corporate Governance Reports: The Position of Employees*

The corporate governance initiatives of the past few years in Australia are discussed in detail below.¹⁵¹ Inevitably, these reports discuss the interests of stakeholders and how directors should consider their interests when they manage a company.

¹⁴⁵ Symes "A New Statutory Directors' Duty" 139–145; Bottomley & Forsyth "Corporate Law" 20 on part 5.8A; Baxt et al. *Corporations* par 9.30.

¹⁴⁶ This section does not refer to "directors", but to "persons". But one could safely assume that the part is concerned with directors who have control over their company and who are forced to "care" for employee entitlements (see Symes "A New Statutory Directors' Duty" 142).

¹⁴⁷ "Entitlements" are defined as wages, superannuation contributions, annual leave and long-service leave (see s 596AA(2)).

¹⁴⁸ See s 307 of the United Kingdom Companies Act of 1985, discussed in ch 3 par 3.1.4 above. It is argued that employees did receive protection in s 309 of the Companies Act of 1985. But employees were not awarded with any rights to enforce the protection afforded to them in s 309.

¹⁴⁹ Symes "A New Statutory Directors' Duty" 144.

¹⁵⁰ Baxt et al. *Corporations* 355; Bottomley & Forsyth "Corporate Law" 14.

¹⁵¹ Paragraph 4 below. These initiatives include the *Corporate Responsibility Report* of June 2006 and the *Social Responsibility Report* of December 2006.

ASX's Best Practice Principles and Recommendations, the *HIH Report* and the *Corporate Social Responsibility Report* of June 2006 specifically consider the interests of employees when directors manage a company.

ASX listed companies have to comply with the *ASX's Best Practice Principles and Recommendations*. These principles and recommendations are not prescriptive rules, but also not completely voluntary. If companies do not comply with the recommendations, they should state in their annual report why they did not comply.¹⁵² Principles of good corporate governance were established by the ASX Corporate Governance Council. Principle 10 of the original *ASX's Best Practice Principles and Recommendations*, issued in March 2003, dealt with the recognition of the legitimate interests of stakeholders.¹⁵³ Recommendation 10.1 required directors to “[e]stablish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders”. This principle is discussed in more detail below.¹⁵⁴ It states that directors should consider the interests of stakeholders when they manage a company, but they should still have flexibility when they manage a company.

These principles were reviewed during 2007 and there is no longer a separate principle dealing with stakeholder interests.¹⁵⁵

The report by Royal Commissioner Mr Justice Neville Owen into the circumstances surrounding the failure of the HIH Insurance Group was released on 16 April 2003.¹⁵⁶

¹⁵² Du Plessis et al. *Principles of Contemporary Corporate Governance* 119.

¹⁵³ See par 4.1 below for a discussion of *ASX's Best Practice Principles and Recommendations*.

¹⁵⁴ Paragraph 4.1 below. Whistleblowers are also protected, since it is stated in box 3.1 that public companies should have a code of good conduct encouraging directors, among other things, to report unlawful or unethical behaviour by employees and set in place protection for those reporting such conduct. Du Plessis et al. *Principles of Contemporary Corporate Governance* 21.

¹⁵⁵ See par 4.1 below on the revised recommendations. Principle 3 is still relevant and determines that companies must promote ethical and responsible decision making. To give effect to this recommendation a company must have a code of conduct to guide directors to act in an ethical manner. How directors should consider the different interests of stakeholders should also be addressed in such a code.

The report identified a number of possible breaches of the Crimes Act¹⁵⁷ and the Corporations Act of 2001. It also included 61 policy recommendations, 17 of which relate to corporate governance issues.¹⁵⁸ These recommendations include that the disclosure and other requirements of the Corporations Act of 2001, the relevant accounting standards and the *Australian Stock Exchange Listing Rules* that relate to directors' remuneration be reviewed to ensure that they achieve clear disclosure of all the remuneration or other benefits paid to directors.¹⁵⁹

The *HIH Report* also provides a valuable explanation of the position of employees in the corporate world. Justice Owen states the following:

It is difficult to define with precision the part employees play in corporate governance. It will depend on the extent to which the employee is involved in or can influence the decision-making process. Senior management is more likely to have such a role. But in large corporations or complex groups it may be that employees further down the corporate hierarchy have a decision-making function that involves elements of control in the process. There is a danger in the current emphasis on the role and responsibilities of the board of directors. It may cause to be overlooked the reality of the necessarily greater part that executives and other employees play in the day-to-day running of many corporate businesses.¹⁶⁰

The Parliamentary Joint Committee on Corporations and Financial Services issued the *Corporate Responsibility Report* on corporate responsibility and “triple-bottom line” reporting in June 2006. This report deals with employees in different contexts. It refers to the position of stakeholders and to the different theories on stakeholder protection. The drafters identify employees as a group that falls under the definition of “stakeholders”.¹⁶¹ The committee favours the enlightened shareholder value

¹⁵⁶ The report is available at <http://www.aar.com.au/corpgov/clerp/hih/rec.htm> (accessed 5 May 2008).

¹⁵⁷ The Crimes Act of 1958.

¹⁵⁸ See part 3 par 6 of the report.

¹⁵⁹ See recommendation 1. Most of the other recommendations deal with financial reporting issues (see part 3 par 7 of the report).

¹⁶⁰ At p 47. See also Du Plessis et al. *Principles of Contemporary Corporate Governance* 21.

¹⁶¹ Paragraph 2.16 of the *Corporate Responsibility Report*.

approach concerning the protection of stakeholders, such as employees. The committee also refers to employees when it deals with possible drivers of corporate responsibility and state that to keep employees motivated is a driving force behind successful corporate responsibility.¹⁶² The committee further refers to employees in the context of sustainable reporting.¹⁶³ It confirms that one of the reasons for directors to report on the affairs of a company is the fact that employees (and other non-shareholder stakeholders) should be informed. The committee is in favour of directors managing a company in the best interests of the shareholders collectively. They suggest that directors should, however, consider the interests of other stakeholders as this will contribute to a maximisation of shareholder wealth.¹⁶⁴

3.2.4.3 *Conclusions: Employees*

It was indicated above that Australian employment contracts do not provide employees with sufficient protection. Employee contracts are often incomplete and employees' expectations cannot be accurately reflected in these contracts.¹⁶⁵ Conciliation and arbitration have improved over the past years. Today parties can negotiate their terms and conditions of employment at enterprise level.¹⁶⁶ Australian labour legislation was also considered and it seems as if employees are not sufficiently protected in this legislation. The Workplace Relations Amendment Act (Work Choices) of 2005 replaced the Workplace Relations Act of 1996. It was indicated that this Act of 2005 weakened the position of trade unions and employees' right to collective bargaining. It was further seen that the position of employers is strengthened by this Act. However, the Corporations Law Amendment (Employee Entitlements) Act of 2000 emphasises the need for directors to consider the interests of employees when exercising their fiduciary duties. But it would be very difficult for employees to prove that directors did not consider their interests when managing the

¹⁶² Paragraph 3.39 of the *Corporate Responsibility Report* of June 2006.

¹⁶³ "Sustainable reporting" refers to the practice of corporate reporting on economic, social and environmental performance. Sustainable reporting is voluntary in Australia. See par 6.6 of the *Corporate Responsibility Report* of June 2006.

¹⁶⁴ See also par 4.3 below on this report.

¹⁶⁵ Paragraph (a) above.

¹⁶⁶ Paragraph (b) above.

company.¹⁶⁷ It seems as if corporate governance initiatives such as the *Corporate Responsibility Report* of June 2006 favour shareholder primacy, subject thereto that stakeholders such as employees should also be protected. In chapter 2 it was argued that directors should manage a company in the best interests of the company as a separate legal entity.¹⁶⁸ The protection afforded various stakeholders will necessarily differ during the existence of a company. The measure of statutory protection that a specific stakeholder receives, other than corporate law legislation, plays an important role in deciding whether or not directors should acknowledge the interests of a specific stakeholder. It would seem that employees do not receive adequate protection elsewhere and directors should keep this in mind when managing a company.

3.2.5 Consumers

There is no case law stating that directors should consider the interests of consumers, but legislation concerning consumer protection obviously also applies to companies.

The Trade Practices Act¹⁶⁹ provides for the protection of consumers and prevents some restrictive trade practices.¹⁷⁰ The object of the Act is “to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection”. With regard to restrictive practices, the general approach is to prohibit anti-competitive business practices, unless it can be indicated that it give rise to the public benefit.¹⁷¹ The provisions dealing with consumer protection prohibit unfair and deceptive practices, and establish a set of implied warranties and conditions. This part of the Act seeks to establish fair trading principles and to

¹⁶⁷ Paragraph (c) above.

¹⁶⁸ Chapter 2 par 5.2 above.

¹⁶⁹ Act 51 of 1974. See Baxt & Brunt “Guide to the Trade Practices Act” 5ff; Sarre “Responding to Corporate Collapses” 3, 23.

¹⁷⁰ See www.answers.com/topic/trade-practices-act-1974 (accessed 5 March 2007). The Act is administered by the Australian Competition and Consumer Commission. (See part II of the Act; see also www.accc.gov.au for the Australian Competition and Consumer Commission (accessed 10 March 2007)).

¹⁷¹ Part IV of the Act deals with restrictive practices. See Baxt & Brunt “Guide to the Trade Practices Act” 6.

promote the supply of information to consumers.¹⁷² Baxt and Brunt state in their guide to the Act that as to scope, the coverage of restrictive and unfair practices in the Act is among the most comprehensive in the Western world.¹⁷³ The following parts of the Act provide extensive protection to consumers:

Firstly, part V division 1 and part VC division 2 concern consumer protection and deal specifically with unfair practices. Unfair practices include misleading and deceptive conduct,¹⁷⁴ unconscionable conduct,¹⁷⁵ bait advertising,¹⁷⁶ pyramid schemes¹⁷⁷ and certain misrepresentations.¹⁷⁸

Secondly, part V, division 1A and part VC, division 3 deal with product safety and information.¹⁷⁹ The provisions in these parts deal with warnings to the public, product safety standards, and unsafe goods and product information standards.

¹⁷² Part V of the Act deals with consumer protection.

¹⁷³ Baxt & Brunt “Guide to the Trade Practices Act” 6.

¹⁷⁴ Individuals and the Australian Competition and Consumer Commission can take action against corporations who engage in misleading or deceptive conduct. See s 52 of the Act which states that “[a] corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive”. No specific definition is given for “misleading” or “deceptive”.

¹⁷⁵ The inclusion of unconscionable conduct in the Trade Practices Act is a codification of the common law. An act is unconscionable if a party to a transaction is under a “special disability”, the other party knows this, but continues to act in a way that makes it unfair or unconscionable to accept the offer of the weaker party. To determine whether a person exercised “unconscionable conduct”, the court will have regard to “the relative strengths of the bargaining positions of the corporation and the consumer; whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation; whether the consumer was able to understand any documents relating to the supply or possible supply of the goods or services; whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the consumer or a person acting on behalf of the consumer by the corporation or a person acting on behalf of the corporation in relation to the supply or possible supply of the goods or services; and the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services from a person other than the corporation” (see s 51AB of the Act). See s 51AC for unconscionable conduct in business transactions.

¹⁷⁶ Advertising a product that is not reasonably available. See s 56 of the Act.

¹⁷⁷ Section 65AAC of the Act.

¹⁷⁸ For example, misrepresentation concerning the price. See s 53 of the Act.

¹⁷⁹ See, *inter alia*, ss 65B, 65C, 65D of the Act.

Thirdly, part V, division 2 concerns conditions and warranties in consumer transactions. There are certain implied conditions in the Act concerning the fitness of the purpose of the product, supply by description or sample and that the goods must be of a merchantable quality.¹⁸⁰

Fourthly, part V, division 2A deals with actions against manufacturers or importers of goods.¹⁸¹ Section 74B(1) states that where a corporation, in trade or commerce, supplies goods manufactured by the corporation to another person who acquires the goods for re-supply and the goods are not fit for the particular purpose for which they were acquired, then the corporation is liable to compensate the consumer or that other person for the loss or damage and the consumer or that other person may recover the amount of the compensation by action against the corporation in a court of competent jurisdiction.¹⁸²

The interests of consumers are of vital importance in the day-to-day running of a corporation. The Trade Practices Act provides an extensive list of consumer rights, like the general prohibition against misleading and deceptive conduct, in part V of the Act.¹⁸³ It would seem that consumers receive adequate protection in terms of this Act.

3.2.6 The Different Interest Groups: Concluding Remarks

The recognition and protection of the interests of stakeholders are very important, especially with regard to the long-term growth of a corporation. It seems that the position in Australia is still that the interests of shareholders should receive primacy when a company is managed.¹⁸⁴ However, there is legislation that adequately

¹⁸⁰ Sections 70, 71(2), 72, 66(2) of the Act.

¹⁸¹ Sections 74A–74M of the Act.

¹⁸² In terms of s 74B(2), subsection 74B(1) does not apply: “(a) if the goods are not reasonably fit for the purpose referred to in that subsection by reason of: (i) an act or default of any person (not being the corporation or a servant or agent of the corporation); or (ii) a cause independent of human control; occurring after the goods have left the control of the corporation; or (b) where the circumstances show that the consumer did not rely, or that it was unreasonable for the consumer to rely, on the skill or judgment of the corporation”.

¹⁸³ Du Plessis et al. *Principles of Contemporary Corporate Governance* 24.

¹⁸⁴ This issue of shareholder primacy has been widely debated by Australian commentators. Most of them are in favour of shareholder primacy, see, for instance, *Paper 3 of CLERP* at p 16; Du Plessis et al. *Principles of Contemporary Corporate Governance* 51–52 who suggests that there is not a

addresses the needs of stakeholders.¹⁸⁵ McConvill suggests that it is not necessary to revise the duties of directors to take into account the interests of specific classes of stakeholders when they make corporate decisions. He states that it is not necessary to clarify the extent to which directors may take into account the interests of specific classes of stakeholders when making corporate decisions. He argues that a proposal of extending directors' duties to include various stakeholders as beneficiaries is based on three false assumptions.¹⁸⁶ The first one is that directors do not take stakeholders' interests into account. According to McConvill, this is not true as the general law and corporate best practices¹⁸⁷ require directors to consider the interests of other stakeholders. The second false assumption is that the interests of stakeholders are contrary to the best interests of the company. This is also not true. Directors have to consider the interests of other stakeholders, because that is in the best interests of the company. Directors should consider the short- and long-term benefits of their decisions, provided that they are in the best interests of the company. There is therefore a very strong link between considering stakeholders interests and doing what is best for the company.¹⁸⁸ The last false assumption is that a stakeholder-orientated approach to corporate governance requires legislative change.¹⁸⁹ A culture

contradiction between the fact that the recognition of stakeholders interests is the best way to ensure long-term sustainable growth for the firm and the fact that directors should manage a company in the best interests of shareholders; McConvill "Directors' Duties to Stakeholders" 88–102. But see Wood "Whom Should Business Serve?" 266–285, who argues that although the shareholder conception of the firm seems morally weak, it appears to have practical strengths. It is practical because it provides directors with a clear goal, namely profit maximisation or shareholder wealth. The stakeholder conception is morally strong, but it lacks practical direction. Morality in this context, according to Wood, relates to the fact that directors should be concerned on how their actions affect others. He argues that the shareholder conception cannot be morally rehabilitated, but the stakeholder conception can be rehabilitated on a practical level. This issue of shareholder primacy has been debated and discussed in various review initiatives of Australia, see par 4 below for a discussion of these initiatives.

¹⁸⁵ For example, consumer legislation. See par 3.2.5 above. This is not necessarily the case with all stakeholders, see for example employees discussed in par 3.2.4 above.

¹⁸⁶ McConvill "Directors' Duties to Stakeholders" 88–102. He refers to the report of the Corporations and Markets Advisory Committee (CAMAC) on social responsibility (issued in December 2006). The Parliamentary Secretary asked this committee in March 2005 to comment on the issue of stakeholder protection. This report is discussed in par 4.3 below.

¹⁸⁷ McConvill "Directors' Duties to Stakeholders" 90–92. On corporate best practices see for instance: *ASX's Recommendations and Principles of Good Corporate Governance* (discussed in par 4.1 below).

¹⁸⁸ McConvill "Directors' Duties to Stakeholders" 95–96.

¹⁸⁹ McConvill "Directors' Duties to Stakeholders" 99.

that appreciates and protects strong relationships with stakeholders will naturally steer directors in the direction of stakeholder protection.

It is clear from the above discussion that the traditional viewpoint in Australia that a company should be managed by the directors in the best interests of the company, being the shareholders collectively, still prevails. However, when directors act in the best interests of the shareholders collectively they also have to consider the interests of other stakeholders. If they do not consider their interests they will be acting against the best interests of the company. Corporate culture and norms, such as best practice codes, are also moving towards stakeholder engagement.¹⁹⁰

3.3 The Duty of Care, Skill and Diligence

The duty of care and skill is a general law duty. This duty arises from contract,¹⁹¹ the existence of an equitable obligation or the common law.¹⁹² This duty of care was originally developed in equity before the evolution of the modern tort of negligence.¹⁹³ Directors are subject to a common law duty to exercise reasonable care and skill in addition to any contractual, equitable¹⁹⁴ or statutory obligations.

The *locus classicus* on the standard of care is the English decision of *Re City Equitable Fire Insurance Co Ltd*.¹⁹⁵ The standard of care and diligence expected of

¹⁹⁰ See the discussion below on corporate governance initiatives in Australia, especially the *Corporate Responsibility Report* of June 2006. The drafters of this report favoured the enlightened shareholder value approach.

¹⁹¹ The duty of care and skill owed to a company by a director under a contract of service with the company will arise from an express term in the contract or, if no such term exists, from an implied term that the employee will exercise reasonable care and skill expected of a person in his position. See *Lister Romford Ice and Cold Storage Co Ltd* [1957] AC 555.

¹⁹² In *Permanent Building Society (in liq) v McGee* (1993) 11 ACSR 260 at 287 it was found that directors owe a duty of care and skill at common law and in equity.

¹⁹³ Farrar *Corporate Governance* 124.

¹⁹⁴ The equitable duty of care and skill may arise from the same facts that give rise to a tortious duty, see *Permanent Building Society* at 287. See, generally, on the Australian duty of care and skill Worthington “The Duty to Monitor” 181–202.

¹⁹⁵ [1925] Ch 407. This case is also discussed in ch 3 par 3.2. See Baxt et al. *Corporations* 428–431 and Redmond *Companies and Securities Law* 380ff on the duty of care and diligence. See also *Marson (Pty) Ltd v Pressbank (Pty) Ltd* (1987) ACLC 338 at 343 and *Fitzsimmons v R* (1997) 23 ACSR 355 at

directors was quite low and the courts expected some form of gross negligence in order to establish a breach of this duty. A subjective test was used to determine whether the duty had been breached. A director did not have to exhibit a greater degree of skill when performing his duties than was reasonably expected of a person with his knowledge and experience.¹⁹⁶ This approach changed with the decision of *Daniels v Anderson*¹⁹⁷ where auditors of a company were held to be negligent because they failed to comply with the Companies Code in respect of foreign exchange operations.¹⁹⁸ The court held that the auditors (as well as the chief executive officer and management of the company) were negligent because the law had developed since the *City Equitable* decision. Directors are now required to take real steps to place themselves in a position to guide and monitor management of the company.¹⁹⁹ In terms of this case, the duty of directors to act with care and diligence

365 where it was held that the common law test relating to a breach of the duty of care and skill is subjective.

¹⁹⁶ At 407. See Cassidy *Corporations Law* 229; Baxt et al. *Corporations* 432 on this issue.

¹⁹⁷ (1995) 13 ACLC 614. Rogers CJ in the Supreme Court of Appeal in *AWA Ltd v Daniels (Trading as Deloitte Haskins & Sells)* (1992) 10 ACLC 933 laid down a framework against which the duties of directors might be measured, specifically non-executive directors. The learned judge held that a director may, *inter alia*, rely without verification on the judgement information and advice of the officers so entrusted. A director may also rely on management to go carefully through the relevant financial and other information of the corporation and draw the board's attention to what is necessary. Reliance would only be unreasonable where "the director was aware of the circumstances of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence, acting on his behalf, would have relied on the particular judgment information and advice of the officers" (*AWA Ltd v Daniels* at 1015). This part of the judgment was especially important for non-executive directors. Rogers held that non-executive directors' duty is subjective in nature. This changed, however, with the subsequent appeal in *Daniels v Anderson* in 1995 where a subjective and an objective test was applied for both executive and non-executive directors (*Daniels v Anderson* at 662).

¹⁹⁸ Before the *Daniels* decision, the Supreme Court of Western Australia had further weakened the standard of care and skill of non-executive directors. See *ASC v Gallagher* (1993) 11 ACLC 286; *Hurley v NCSC* (1993) 11 ACLC 443; *Vrisakis v ASC* (1993) 11 ACLC 763. See Cassidy *Corporations Law* 229 ff.

¹⁹⁹ At 664 in the *Daniels v Anderson* case. The court also discussed various decisions in American law, which placed the standards required from directors at a high level and held that the court could not adopt a passive role. See, for example, *Francis v United Jersey Bank* 432 A 2d 814 (1981). The court's finding in *Daniels v Anderson* that the duty of care imposes an objective standard was followed in *South Australia v Marcus Clark* (1996) 19 ACSR 606 at 627; *Gamble v Hoffman* (1997) 24 ACSR 369 at 372. See also, generally, Cassidy *Corporations Law* 231 ff.

is largely objective, but there are no “uniform standards for directors”.²⁰⁰ Australian courts now expect high levels of care and diligence of directors.²⁰¹

The duty of care and skill is entrenched in Australian corporate legislation.²⁰² Section 180(1) of the Corporations Act of 2001 provides that a director or other officer of a corporation should exercise his or her powers and discharge his or her duties with the degree of care and diligence that a reasonable person would exercise if he or she was a director or an officer of a corporation in the corporation’s circumstances and occupied the office held by, and had the same responsibilities within the corporation as, that of director or officer. This standard is much higher than the original one imposed in terms of the common law. Directors cannot rely on the excuse that, subjectively, they lacked the knowledge or experience to take a particular decision.²⁰³

Section 180(2) contains a statutory business judgment rule. It states that directors or officers who make a business judgment are taken to meet the requirements of care and diligence in terms of section 180(1), and the equivalent duties at common law

²⁰⁰ On the objective test see *ASIC v Rich* (2003) 44 ACSR 341; *Deputy Commissioner of Taxation v Clark* (2003) 45 ACSR 332; *ASIC v Vines* (2005) 55 ACSR 617; *Federal Deposit Insurance Corp v Bierman* 2 F 3d 1424 (1993). See also Austin et al. *Company Directors* 256.

²⁰¹ Du Plessis et al. *Principles of Contemporary Corporate Governance* 259; Austin et al. *Company Directors* 250; Ford et al. *Ford’s Principles of Corporations Law* par 8.340. See also *Wilkinson v Feldworh Financial Services Pty Ltd* (1998) 29 ACSR 642 at 693; *Australian Securities Commission v As Nominees Ltd* (1995) 62 FCR 504 at 517–518 suggesting a higher standard of care and diligence.

²⁰² In response to the recommendations contained in the *Company Directors’ Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* issued by the Senate Standing Committee on Legal and Constitutional Affairs (November 1989) (also known as the *Cooney Report*) available at http://www.lipton-herzberg.com.au/law_reform.htm (accessed 5 May 2008) the statutory duty is now embodied in s 180(1) (formerly s 232(4)). This new section was an attempt to address some of the criticism of the pre-*Daniels v Anderson* common law test. See Cassidy *Corporations Law* 235.

²⁰³ In *Re One.Tel Ltd (in Liq)*; *ASIC v Rich* (2003) 44 ACSR 682, a joint managing director was held to have breached s 180(1) by failing to monitor management, take reasonable steps to assess the company’s financial position and performance, maintain cash reserves at a level that ensured liquidity and ensure the establishment of appropriate systems to produce financial information which was accurate and reliable. See further Austin et al. *Company Directors* 232 on the *One.Tel* case. See also *Forge v ASIC* (2004) 213 ALR 574 (CA) where the directors breached s 232(4) (now s 180(1)) in that the claims for management fees were fictitious and was seen as a way to benefit themselves financially and *ASIC v Loiterta* (2004) 50 ACSR 693 where the directors breached s 232(4) (now s 180(1)) by approving a dividend out of profits when the company did not have any profits. See Ford et al. *Ford’s Principles of Corporations Law* at par 8.305 on the statutory standard of care and skill; Austin et al. *Company Directors* 229–231.

and in equity, if they make the judgment in good faith for a proper purpose, do not have a material interest in the subject matter of the judgment, inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate and rationally believe that the judgment is in the best interests of the corporation. The “judgment” refers to any decision taken or not taken concerning a matter relevant to the business operations of the corporation.²⁰⁴

4 CORPORATE GOVERNANCE INITIATIVES AND THE STAKEHOLDER DEBATE

In the next section a brief overview of the most important corporate governance initiatives in Australia is provided. The discussion focuses on how stakeholders are dealt with in terms of these initiatives.

4.1 ASX’s Best Practice Principles and Recommendations

ASX listed companies have to comply with the *ASX’s Best Practice Principles and Recommendations*.²⁰⁵ If they do not comply with the recommendations they should state in their annual report why they did not comply.²⁰⁶ These principles of good corporate governance were established by the ASX Corporate Governance Council which was founded on 15 August 2002. The Council developed ten principles on corporate governance and approved the *ASX’s Best Practice Principles and Recommendations* in March 2003. The *ASX’s Best Practice Principles and*

²⁰⁴ Austin et al. *Company Directors* 237–238; Farrar *Corporate Governance* 138–141; Redmond “Safe Harbour or Sleepy Hollows” 79; Cassidy “Standards of Conduct” 180 on arguments for and against the business judgment rule. See also *Re HIH Insurance Ltd (in liq) v Adler* (2002) 41 ACSR 72; *Adler v ASIC* (2003) 46 ACSR 504. In these cases the defendants were denied the benefit of the business judgment rule.

²⁰⁵ See par 3.2.4.2 above. Most of the recommendations only applied to companies from 1 July 2004. There are comparable guidelines for non-listed companies, see *Standards Australia* (June 2003) available at www.standards.org.au (accessed 10 April 2007). On these initiatives generally, see Baxt et al. *Corporations* xxvii.

²⁰⁶ These principles and recommendations are therefore not mandatory rules, it operates on a comply or explain basis or “if not why not” approach. It is therefore not completely voluntary as companies still need to explain why they did not comply. This is similar to the approach followed in terms of *King II* in South Africa, discussed in ch 6 par 4.1 below.

Recommendations consist of four parts, namely: (1) corporate governance in Australia, (2) the essential corporate governance principles, (3) best practice recommendations and (4) two attachments. There are 28 recommendations²⁰⁷ that provide implementation guidance for listed companies to satisfy the ten principles of good corporate governance. The document consisted of ten chapters, each explaining one of the ten corporate governance principles. For purposes of this thesis, principles 3 and 10 are important.²⁰⁸

Principle 3 concerns the promotion of ethical and responsible decision making. The council recommendation states that: “investor confidence can be enhanced if the company clearly articulates the practices by which it intends directors and key executives to abide”.²⁰⁹ Recommendation 3.1 recommends the following: “Establish a code of conduct to guide directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any key executives as to the practices

²⁰⁷ These recommendations include that the majority of the board should be independent directors (par 2.1), that the board should establish a remuneration committee (par 9.2) and, very importantly, that a code of conduct should be established. Compliance with legal and other obligations to legitimate stakeholders should also be disclosed (par 10.1). See Du Plessis et al. *Principles of Contemporary Corporate Governance* 134–137; Blackmore “Regulating Regime” 47–49; Havenga “Duties of the Company Chairman” 145; Von Nessen “Corporate Governance in Australia” 199–200, 205–206. See also Grantham “Corporate Governance Codes” 218–225 where he discusses the ASX’s *Best Practice Recommendations and Principles* as well as the New Zealand version, *Corporate Governance in New Zealand: Principles and Guidelines* (2004). Grantham discusses whether these two codes address the agency-cost problem. The agency-cost problem concerns senior management who act in their own self-interest. He argues that the codes do address this problem, based on the principles dealing with independent boards and financial reporting. He also deals with the question of whether or not the codes improve governance. He maintains that the solution does not necessarily lie in independent directors, since they do not have detailed knowledge of the nature of the company’s business and must therefore rely on senior management. Independent directors are also only part time and they do not always give enough time to the affairs of the specific company. He believes further that the codes are overly concerned with corporate scandals and corruption. Accountability is only one aspect of corporate governance, the quality of decision making and the realisation of wealth is also important. Propriety in management is a prerequisite for wealth maximisation, but it is not an end in itself. He therefore considers it a pity that the codes did not pay more attention to the creation of wealth.

²⁰⁸ Principle 1 states that solid foundations should be laid for management and for oversight. A board charter should be established for this purpose. Principle 2 concerns the structure of the board and that it should add value. A nomination committee is proposed in this regard. Principle 4 concerns the safeguarding of integrity in financial reporting. A formal audit committee charter should be established to give effect to this principle. Principle 5 relates to timely and balanced disclosure. Written policies should be established to ensure listing and statutory disclosures. Principle 6 states that the rights of shareholders should be respected; this can be achieved by way of a communication policy. Principle 7 states that risk should be recognised and managed. A risk management policy is important to adhere to this principle. Principle 8 concerns the encouragement of enhanced performance and principle 9 deals with fair and responsible remuneration. A remuneration committee should be established for this goal.

²⁰⁹ ASX’s *Best Practice Recommendations and Principles* p 25.

necessary to maintain confidence in the company's integrity;²¹⁰ the responsibility and accountability of individuals for reporting and investigating reports of unethical practices."²¹¹ Such a code is an effective way to guide the behaviour of directors and demonstrate the commitment of a company to its ethical practices.²¹² It is suggested in Box 3.1 of *ASX's Best Practice Principles and Recommendations* that the following content should be addressed in this code: provisions on conflict of interests, corporate opportunities, confidentiality, fair dealing, protection and proper use of information, compliance with laws and regulations, and encouraging the reporting of unlawful behaviour.

Principle 10 deals with the recognition of the legitimate interests of stakeholders. A code of conduct is proposed and suggestions are provided as to what provisions should be included in such a code.²¹³ If these suggestions are not followed, an explanation should be provided. Recommendation 10.1 states: "Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders." Listed companies should have a code of conduct to guide compliance with their legal and other obligations to stakeholders. Guidelines for the contents of the code of conduct are also provided²¹⁴ with reference to the company's responsibility towards consumers, employment practices, the community and how the company should comply with legislation affecting its operations.²¹⁵ These guidelines include a clear commitment by the board of directors to adhere to the code of conduct especially relating to its statements on the aspirations and objectives of the company and its core values. Responsibilities to shareholders and the financial community in general should also be included in the code of conduct. This might include reference to the company's viewpoints on delivering shareholder value and how it should be

²¹⁰ See par 3.1.1 of *ASX's Best Practice Recommendations and Principles*.

²¹¹ See par 3.1.2 of *ASX's Best Practice Recommendations and Principles*.

²¹² Du Plessis et al. *Principles of Contemporary Corporate Governance* 204.

²¹³ This code may stand alone or be part of the code mentioned in Principle 3 above.

²¹⁴ See Box 10.1 in the *ASX's Best Practice Recommendations and Principles*. This code can be compared with the *Code of Best Practice* in the United Kingdom (see ch 3 par 4.1) and the *South African Code of Corporate Practices and Conduct* in terms of *King II* (see ch 6 par 4.1).

²¹⁵ See also the *Corporate Responsibility Report* ch 7 of June 2006 pars 7.27–7.38.

achieved, as well as the company's approach to accounting policies and practices. The code of conduct should also make provision for responsibilities to clients, customers and consumers. This might include reference to standards of product quality or service and a commitment to fair value and safety of goods produced. Environmental protection policies, support for community activities and donations or sponsorships should also be included in the code of conduct. The company's privacy policy and the use of confidential information should, furthermore, be covered in the code of conduct. The company's compliance with legislation affecting its operations and how the company monitors and ensures compliance with the code of conduct is also very important and should be included in it. These guidelines are only suggestions on the contents of the code of good conduct. Companies have flexibility to include other issues or exclude some of the above-mentioned matters. The main aim of a code of good conduct is to state the values and policies of a company and to ensure adequate public or social accountability by corporations.²¹⁶

ASX's Best Practice Recommendations and Principles were reviewed during 2007 and new revised recommendations and principles were issued in August 2007. The aim of the revision was to reduce the number of principles and to simplify the principles. There are now eight, instead of ten, principles. The previous principles 8²¹⁷ and 10 are no longer separate. Stakeholders are now dealt with in terms of principle 3 and recommendation 3.1.²¹⁸ Principle 3 deals with the promotion of ethical and responsible decision making.²¹⁹ It states that when companies make ethical and responsible decisions they should not only be aware of their legal obligations, but also consider the reasonable expectations of their stakeholders, like shareholders, employees, customers and creditors. Recommendation 3.1 provides for a code of conduct that companies should issue. In terms of such a code, companies should state what their viewpoints are on stakeholder protection.

²¹⁶ Du Plessis et al. *Principles of Contemporary Corporate Governance* 31.

²¹⁷ Principle 8 related to the encouragement of enhanced performance.

²¹⁸ Principle 10 is therefore embedded in principle 3, but only to a limited extent.

²¹⁹ The new Principle 3 is much wider than Principle 3 in the March 2003 version of *ASX's Principles and Recommendations*. In terms of the new Principle 3, it is recommended that directors must have regard to stakeholders' interests when managing a company.

It is clear that ASX has assumed an important role in the regulation of corporate governance in Australia. Du Plessis and others argue that the extent to which ASX becomes involved in corporate governance in Australia over the long and medium term depends on two factors. First, the extent to which companies attempt to comply with the recommendations and, second, the attitude of ASX towards monitoring and enforcing non-compliance by listed companies. The principles and recommendations have not yet been in force for long enough to allow for an accurate evaluation. Du Plessis and others²²⁰ argue further that ASX should assume a dual role, namely as educator and as regulator. As regards its role as educator, ASX should explain the recommendations and how they operate. They should, furthermore, provide guidelines on how companies can use the recommendations to set in place corporate governance policies that will suit their particular business. As enforcer, ASX has not assumed a strong role. The main reason for this is the nature of the principles and recommendations. They are intended to be only guidelines. The principles and recommendations are not prescriptive rules. However, the recommendations are supported by the *Listing Rules*²²¹ and *Listing Rule* 4.1.0.3 provides that listed companies are required to comply with the recommendations or explain why they did not comply in their annual reports. Failure to provide a sufficient explanation will result in a breach of the *Listing Rules*.²²² ASX did not make it clear what would qualify as a sufficient explanation, but did indicate that they will question the companies that did not comply with the recommendations and assist them in complying, instead of imposing sanctions on companies.²²³

²²⁰ Du Plessis et al. *Principles of Contemporary Corporate Governance* 136–137.

²²¹ The *Australian Stock Exchange Listing Rules*.

²²² A breach of the *Listing Rules* would result in penalties: see ss 793B and 793C of the Corporations Act 2001. See Ramsay and Hoad “Disclosure of Corporate Governance Practices”, who conducted a study to determine the extent to which Australian listed companies are disclosing their corporate governance practices, in terms of rule 4.10.3, by examining the annual reports of 268 listed companies.

²²³ Du Plessis et al. *Principles of Contemporary Corporate Governance* 137.

I submit that the ASX's recommendations are similar to the suggestions made in the *King II Report* in South Africa.²²⁴ They are mainly suggestions and encourage flexibility in directors' management of a company. Both sets of recommendations are supported by the Listing Rules of the respective countries.²²⁵

In conclusion, in terms of the new revised ASX's *Principles and Recommendations* listed companies should ensure that stakeholders are aware of decisions made by management. This should be included in a company's code of conduct. Non-listed companies should also strive to keep stakeholders informed.

4.2 The Corporate Law Economic Reform Program

4.2.1 Introduction

In March 1997 the Federal Treasurer announced the CLERP. It involved a review of key areas of regulation affecting businesses and investment activities. The CLERP was developed with the benefit of consultation with the Business Regulatory Advisory Group. This group should provide feedback to the government on business and corporate law reform. Since 1997 there have been nine policy proposal documents.²²⁶

Paper 3 of CLERP,²²⁷ dealing with directors' duties and corporate governance is discussed below.²²⁸

²²⁴ This report is discussed in ch 6 par 4.1 below.

²²⁵ See ch 6 par 4.1 where *King II* is discussed.

²²⁶ Du Plessis et al. *Principles of Contemporary Corporate Governance* 149. Paper 1 concerns accounting standards, Paper 2 fundraising, Paper 3 directors' duties and corporate governance, Paper 4 takeovers, Paper 5 electronic commerce, Paper 6 financial markets and investment products, Paper 7 simplified lodging and compliance procedures with the Australian Securities and Investments Commission (ASIC) (see pars 2 and 3.1 above on ASIC), Paper 8 cross-border insolvency and Paper 9 audit reform and corporate disclosure. The first four papers and a part of the fifth one were reflected in the Corporate Law Economic Reform Program Act 156 of 1999. The sixth paper led to the Financial Services Reform Act 2001 (which took effect in March 2004). Paper 7 was also adopted and took effect from July 2003. Paper 9 (*CLERP 9*) took effect in July 2004. Paper 8 has not been implemented as yet. See the speech by the Hon Justice IDF Callinan on 28 October 1998 at the Corporations Law Update Conference at the Sydney Marriot Hotel available at www.treasury.gov.au (accessed 2 March 2007).

²²⁷ *Corporate Law Economic Reform Program: Paper 3* (Directors' Duties and Corporate Governance).

4.2.2 Paper 3: Directors' Duties and Corporate Governance

The main objective of this policy proposal paper was to improve corporate governance. It was accepted that entrepreneurial activity and directors' accountability need to be correctly balanced,²²⁹ but that flexibility and innovation should not be compromised.²³⁰ A number of proposals are made in this paper. The first proposal concerns a statutory business judgment rule and a statutory derivative action.²³¹ The second proposal relates to amendments concerning certain obligations of directors, such as to replace the duty of directors to act honestly with a duty to act in good faith in the best interests of the corporation and for a proper purpose.²³² The third proposal is that a company's ability to indemnify officers for legal expenses should be clarified.²³³ The fourth proposal concerns the desirability of a standard form of due diligence defence for directors and the last proposal concerned the monitoring of corporate governance practices by Australian companies.²³⁴

The second proposal is important for purposes of this thesis. It recommends that directors should be certain of their duties to the company. A dual test is recommended in respect of the duty of care and diligence based on objective and subjective elements.²³⁵ It is also proposed that a breach of the duty of care and diligence should only give rise to civil sanctions and not to criminal penalties.²³⁶ More importantly for purposes of this thesis, it is proposed that directors should exercise their powers and discharge their duties in good faith in the best interests of

²²⁸ *CLERP 9* constitutes one of the most significant packages of corporate law. Most of the reforms of *CLERP 9* are, however, in the area of audit and financial reporting and is not important for purposes of this thesis. The issue of stakeholder protection is not discussed in *CLERP 9*.

²²⁹ Part 2 par 2.1

²³⁰ Part 3 par 3.4.

²³¹ Part 5.

²³² Part 4.

²³³ Page 50.

²³⁴ Page 54. See pp 1–4 for the proposals.

²³⁵ Proposal 2 in the report.

²³⁶ Part 4 par 4.3.2.

the corporation and for a proper purpose.²³⁷ Part 4²³⁸ of the Policy Paper confirms that the role of directors is to oversee the management of a company on behalf of its members. Directors are responsible for maximising the value of the company for the benefit of the members, subject to the legal framework and economic environment in which the company operates. Directors should therefore also ensure that the company meets its contractual and other obligations, such as in relation to the environment, trade practices, fair trading and occupational health and safety.²³⁹ When directors manage a company, they are subject to various duties as entrenched in the constitution of the specific company, the general law and legislation, including but not limited to, corporations law.²⁴⁰

Part 7 relates to corporate governance trends on domestic and international level. The shareholder and stakeholder models are compared. It is confirmed that the corporate governance structures of common law countries, such as Australia and the United Kingdom, are based on the outside or shareholder model of corporate control.²⁴¹ The stakeholder or inside model, in contrast, is applied in civil law countries, such as France, the Netherlands and Italy. In terms of this model, directors should seek to align the interests of the various stakeholders, such as workers, creditors, suppliers and customers.²⁴² In Australia therefore the corporate managers are accountable to the shareholders. The focus of this model is profit maximisation for the owners of the corporation. It is, however, acknowledged that elements of the stakeholder or inside model are also present in Australia. For example, the ability of creditors to initiate voluntary administrative procedures of the corporations law is indicative of the presence of elements of the stakeholder model.²⁴³

²³⁷ Paragraph 3.2 above.

²³⁸ See also part 6.5, par 6.5.1.

²³⁹ Part 4 par 4.1.

²⁴⁰ Other legislation may also impose duties on directors, such as environmental control legislation. See part 4 par 4.4.

²⁴¹ This model is discussed in ch 2 par 4 above.

²⁴² Part 7 par 7.2.1.

²⁴³ Part 7 par 7.2.1.

It is acknowledged that both the shareholder and stakeholder models have experienced some failures in the past.²⁴⁴ A recent economic analysis of laws governing investor protection in 49 countries was inconclusive in passing judgement on the preferred system.²⁴⁵ The researchers indicated that the type of legal system is not always that important as investors can generally contract around any limitations of a particular system.²⁴⁶ It does, however, appear that the shareholder model is preferred in *Paper 3* of *CLERP*. The drafters make the following proposal on a director's duty of good faith:

The existing duty in subsection 232(2) to act honestly should be reformulated to capture the fiduciary principles that a director or other officer of a corporation must exercise their powers and discharge their duties:

- (a) in good faith in the best interests of the corporation; and
- (b) for a proper purpose.

When discussing directors' duties in part 4, the drafters state that directors should act in the best interests of the corporation and maximise shareholder value. They qualify this statement by stating that directors should also keep other obligations like contractual obligations in mind.²⁴⁷ The interests of stakeholders and whether or not directors should consider it when managing a company did not receive specific attention in this Paper.

4.3 The Corporate Responsibility Report of June 2006

The Australian Parliamentary Joint Committee on Corporations and Financial Services issued a report on corporate responsibility and "triple-bottom line" reporting in June 2006. This report is of specific importance for purposes of this thesis and is discussed in detail below.

²⁴⁴ Part 7 par 7.2.1.

²⁴⁵ Part 7 par 7.2.1.

²⁴⁶ The particular system of corporate governance is, however, important for the stakeholders of the company as they cannot always contract out of the limitations.

²⁴⁷ Part 4 par 4.1.

The committee's terms of reference for investigation of the committee, as provided in chapter 1, were the following:

- a) The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community
- b) The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community
- c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community
- d) Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the committee will also have regard to obligations that exist in laws other than the Corporations Act.
- e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.
- f) The appropriateness of reporting requirements associated with these issues
- g) Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia²⁴⁸

These issues are crucial to the investigation in this thesis and to the questions asked in chapter 1.

Chapters 1 and 2 of the report provide an introduction and some background concerning corporate responsibility. Chapter 3 deals with drivers and principles of corporate responsibility,²⁴⁹ chapter 4 deals with directors' duties and chapter 5 with

²⁴⁸ Page viii and ch 1 par 1.1.

²⁴⁹ In this chapter the question is asked whether companies should use their resources to undertake activities that are without any direct financial benefits or return. It is stated that companies are becoming increasingly aware that managing non-financial risks and pursuing opportunities to undertake corporate responsibility activities may benefit the long-term performances of the company (at par 3.16).

institutional investors.²⁵⁰ Chapters 6 and 7 concern sustainability,²⁵¹ and chapter 8 deals with the encouragement of corporate responsibility. For purposes of this thesis, chapters 1, 2, 4 and 8 are particularly relevant.

It is stated in chapters 1 and 2 of the *Corporate Responsibility Report* that corporate responsibility relates to the economic, social and environmental impacts of a company's activities.²⁵² Corporate responsibility implies that companies take an "enlightened" approach to consider the interests of company stakeholders.²⁵³ Stakeholders are, according to the report, groups and individuals that are impacted on by the activities of a company and they can have an impact on corporate activity.²⁵⁴ The following definition is attributed to stakeholders:

The term 'stakeholder' covers a wide array of interest holders depending on the definition used. It is important to recognise that the stakeholder definition used impacts on what is required of corporations to meet CSR demands. Early stakeholder theory focused on the managerial model of an entity and, as a result, narrowly defined 'stakeholder' as a group that impacts on the success of the organisation in terms of production outcomes and transactions. The broader definition of the stakeholder view of the firm includes those who may affect or be affected by the organisation, employees, customers, local community, management, owners and suppliers and so on.²⁵⁵

²⁵⁰ Institutional investors can have an important influence on corporate behaviour. Evidence shows that institutional investors are increasingly considering non-financial factors, because these factors influencing the company's financial future. The availability of relevant information is important in order for institutional shareholders or investors to consider these non-financial factors (at ch 5 of the *Corporate Responsibility Report*).

²⁵¹ "Sustainability" refers to the practice of measuring and publicly reporting on economic, social and environmental performances, as well as future prospects. A number of arguments were raised concerning voluntary versus mandatory reporting. The committee was in favour of voluntary reporting, indicating that mandatory reporting can lead to box-ticking. Particular attention was given to the reporting requirements in terms of the *ASX's Best Practice Principles and Recommendations*, although an "if not why not" approach is followed (at ch 6 of the *Corporate Responsibility Report*).

²⁵² Chapter 1 pars 1.1–1.10 and also ch 2 par 2.7.

²⁵³ Chapter 2 par 2.7.

²⁵⁴ Paragraph 2.16.

²⁵⁵ Chapter 2 par 2.17.

It is further held that “the terms ‘corporate social responsibility’, ‘corporate social transparency’, ‘triple bottom line’, ‘corporate sustainability’ and ‘social and environmental responsibility’ are all used to refer to the same concept”.²⁵⁶

Chapter 4 deals with directors’ duties.²⁵⁷ The committee considered a number of arguments on whether or not directors should consider the interests of stakeholders when they manage a company.²⁵⁸ The question whether a legislative change was necessary to permit or require responsible corporate behaviour was specifically considered. In contrast it was argued that directors will breach their duties if they give consideration to any factors other than maximising profits.²⁵⁹ The committee, in turn, received opinions that directors may consider the interests of other stakeholders, but only to the extent that they are relevant to the corporation.²⁶⁰ The last-mentioned approach is favoured in the report.²⁶¹ This approach is referred to as the “enlightened self-interest approach”. The committee argued that there is no need for any legislative changes directing directors to take into account the interests of other stakeholders.²⁶² Nothing in current legislation constrains directors from contributing to the long-term development of the corporation, by taking account of the interests of stakeholders. Any failure by corporations to focus on the interests of stakeholders is not due to the fact that there is no legal regulation obliging directors to do so. The solution is therefore unlikely to be of a legislative nature.

²⁵⁶ Chapter 2 par 2.5.

²⁵⁷ Chapter 4 pars 4.2–4.8.

²⁵⁸ Various interpretations of what the existing legal framework put forward regarding corporate responsibility were discussed. These interpretations can be classified into four groups, namely: (1) the directors’ restrictive interpretation (directors cannot undertake activities based on corporate responsibility, such activities will not be in the direct best interests of the corporation), (2) the shareholders’ restrictive interpretation (corporations undertake activities based on corporate responsibility to invest those funds for shareholder wealth), (3) the short-term interests interpretation (investment in corporate responsibility is allowed, but only if it can be justified on the basis of annual return on investments), and (4) the enlightened self-interest interpretation (careful appropriate corporate responsibility is almost always in the interests of the corporation, and thus falls within the actions permitted by directors in terms of their current duties) (at 4.11).

²⁵⁹ This argument is referred to as the “directors’ restrictive interpretation”. See ch 4 par 4.12.

²⁶⁰ Chapter 4 par 4.32.

²⁶¹ Chapter 4 par 4.39.

²⁶² Chapter 4 par 4.40.

The committee recommended “that the Corporations Act 2001 permits directors to have regard for the interests of stakeholders other than shareholders, and recommends that amendments to the directors’ duties provisions within the Corporations Act are not required”.²⁶³

Chapter 8 concerns the encouragement of corporate responsibility. Despite the fact that it was the view of the committee that the consideration of stakeholder interests should not be included as part of directors’ duties, it recognised that it was necessary to also consider broader corporate responsibilities. Corporate responsibility can be encouraged through, for example, business and industry initiatives. Businesses could undertake activities which fall under the broad banner of “corporate responsibility”, for example, an industry led corporate responsibility network.²⁶⁴ Reference was made to the Business in the Community (BITC) initiative in the United Kingdom as a successful industry-led corporate responsibility network. BITC describes itself as “a unique independent business led charity whose purpose is to inspire, engage, and support and challenge companies, to continually improve the impact they have on society”.²⁶⁵ BITC provides a platform for collaboration between businesses and for sharing best practice. It works with businesses to develop practical and sustainable solutions to manage and embed responsible business practice.²⁶⁶ The committee recommended that “the Australian government provide seed funding to establish an organisation, the Australian Corporate Responsibility Network, to be modelled on the United Kingdom initiative Business in the Community”.²⁶⁷

The structuring of directors’ remuneration is another option to encourage corporate responsibility. Directors’ remuneration and packages are generally based on the

²⁶³ Recommendation 1, par 4.78.

²⁶⁴ Chapter 8 par 8.12.

²⁶⁵ Chapter 8 par 8.12.

²⁶⁶ Chapter 8 par 8.13. The Australian Business and Community Network also joined BITC because “because they recognise the value of integrating policy and practice and the internal dialogue this prompts” (see par 8.15).

²⁶⁷ Chapter 8 paragraph 8.19.

company's 12- to 36-month returns to shareholders. It is therefore important for directors to maximise profits over the short-term. The committee also heard evidence that these short-term incentives work against corporate responsibility initiatives and long-term shareholder value.²⁶⁸ Evidence was received on innovative remuneration components being linked to specific community, market, environmental, health and safety targets.²⁶⁹ The committee recommended that "investors, stakeholders and relevant business associations should encourage companies to include long-term (beyond a three- to five-year timeframe) and corporate responsibility performance measures as part of the remuneration packages of company directors, executive officers and managers".²⁷⁰

The committee also discusses the role of government in facilitating and promoting corporate responsibility. The Australian government is currently undertaking a range of activities designed to promote corporate responsibility. These activities include the Prime Minister's Community Business Partnership and various sustainability initiatives. The Australian Prime Minister's Community Business Partnership²⁷¹ consists of a group of prominent Australians from the community and business sector who foster community business partnerships, act as a "thinktank" on philanthropic matters and promote corporate giving and corporate social responsibility.²⁷² The idea is that the government, the community and businesses work together to address social challenges. In terms of this partnership the Prime Minister issue awards for excellence in community business partnerships every year. The award is given to a business partnership who contributes to addressing community concerns in an effective manner.²⁷³ Other major awareness activities undertaken by the partnership include: National Community Business Partnerships Week, the Corporate Social

²⁶⁸ Chapter 8 paragraph 8.24.

²⁶⁹ Chapter 8 pars 8.24–8.30.

²⁷⁰ Recommendation 14.

²⁷¹ Established in 1999.

²⁷² Chapter 8 par 8.59–8.74. For a summary on ch 8 see pp xvi–xix.

²⁷³ Chapter 8 paragraph 8.66.

Responsibility Essay Competition,²⁷⁴ and the granting of sponsorships for various conferences and seminars.²⁷⁵ The evidence that the committee received indicated that the work of the partnership was seen as a positive step by the Australian government to promote corporate responsibility.²⁷⁶

The *Corporate Responsibility Report* therefore supports the enlightened shareholder value approach (or enlightened self-interest approach) and states that an effective director will realise that it is in the best interests of the corporation to consider the interests of other stakeholders.²⁷⁷ It suggests that mandatory approaches to corporate responsibility are not appropriate, because nothing in the Corporations Act of 2001 prevents directors from considering the interests of other stakeholders than the shareholders. The committee recommends other methods to encourage directors to consider the interests of other stakeholders.

4.4 The Social Responsibility Report of December 2006

In December 2006 another report, the *Social Responsibility of Corporations Report*, was issued by the Corporations and Markets Advisory Committee.²⁷⁸ The committee confirmed that corporate social responsibility is in essence focused on the way in which the affairs of companies are conducted, with particular reference to its environmental and social impact.²⁷⁹ The committee considered various approaches to the issue of social responsibility, including the compliance, philanthropic, business and social primacy, and social obligation approaches. The first few approaches mentioned are directly and indirectly linked to corporate benefit. But the social primacy and social obligation approaches are not necessarily linked to corporate

²⁷⁴ The essay competition provides an opportunity for both high school and university students to express their opinions about the role of business in society.

²⁷⁵ Chapter 8 paragraph 8.70.

²⁷⁶ Chapter 8 paragraph 8.71.

²⁷⁷ Chapter 4 par 4.76.

²⁷⁸ Hereafter the *Social Responsibility Report* available at www.camac.gov.au (accessed 15 October 2007).

²⁷⁹ Paragraph 2.1 of the *Social Responsibility Report*.

benefit. In view of these approaches, the Advisory Committee was asked to consider the interests directors should or may take into account in corporate decision making. They also had to consider how corporations should report on the social and environmental impact of their conduct.²⁸⁰

In terms of the compliance approach, companies are obliged to comply with the “letter of the law”, but companies may benefit from complying with the “spirit of the law”.²⁸¹ The philanthropic approach involves companies giving to the community in a variety of financial or other ways above and beyond their primary business activities.²⁸² The business approach, also referred to as the “self-interest approach”, suggests that, beyond a company’s obligation to comply with environmental and social laws, it is likely to be in a company’s own commercial interests (in terms of long-term value and risk reduction) to take account of the environmental and social contexts in which it operates.²⁸³ The social primacy and social obligation approaches state that directors should take ethical goals into account in their corporate decision making whether or not this enhances corporate profit or shareholder gain.²⁸⁴

In respect of directors’ duties, the committee did not support a revision of the Corporations Act of 2001. They argued that the established formulation of directors’ duties allows sufficient flexibility to take relevant interests and the broader community into account when managing a company. The committee suggested that the business approach provides an appropriate framework within in which companies can respond to issues of social responsibility. This conclusion was mainly based on the fact that directors have adequate flexibility in terms of the current law to act in a

²⁸⁰ Paragraph 1.1 of the *Social Responsibility Report*.

²⁸¹ Paragraph 2.3.1 of the *Social Responsibility Report*. To comply with “the spirit of the law” will help to safeguard the company against reputational and other risks to longer-term shareholder value arising from perceived attempts to flout the intent of the law.

²⁸² Paragraph 2.3.2 of the *Social Responsibility Report*. Philanthropy in this context may go beyond corporate donations to charitable causes. It can, for example, extend to corporate sponsorship and direct involvement with particular communities in social projects.

²⁸³ Paragraph 2.3.3 of the *Social Responsibility Report*.

²⁸⁴ Paragraphs 2.3.4–2.3.5 of the *Social Responsibility Report*.

socially responsible manner. They are able to have regard to the interests of stakeholders, but they should remain accountable to the shareholders.²⁸⁵

The committee further recommended that the most effective way to address concerns relating to environmental and social impacts are by specific legislative measures directed at the specific issue. This is in line with the recommendations of the *Corporate Responsibility Report* of June 2006.

5 CONCLUSIONS

This chapter considered in whose interests directors should act when they manage a company under Australian law. First, a brief overview was provided on the general and statutory duties of directors. It was seen that directors' duties have been partially codified in the Corporations Act of 2001.²⁸⁶ When considering Australian case law it seems as if the statutory duties are relied on much more than the general duties.²⁸⁷ It is clear from Australian case law that if a code of directors' duties is drafted in clear terms directors will be certain of what is expected of them.²⁸⁸

The traditional position in Australia is that directors should act in the best interests of the shareholders collectively. However a number of corporate governance initiatives such as the *Corporate Responsibility Report* of June 2006 in Australia indicate that the enlightened shareholder value approach (or business approach or enlightened self-interest approach) should be followed.²⁸⁹ Directors should therefore consider the interests of other stakeholders when they manage a company. But stakeholders are

²⁸⁵ This approach is in line with the approaches followed in the United Kingdom and South Africa (specifically in terms of the South African *Policy Document* of 2004). See chapters 3 and 6 in this regard.

²⁸⁶ Paragraph 3.1 above.

²⁸⁷ Paragraph 3.1 above.

²⁸⁸ Paragraph 3.1 above.

²⁸⁹ Paragraph 4 above.

not directly referred to in the Act as is the position in the United Kingdom.²⁹⁰ The protection of stakeholders' interests is still self-regulatory and is based on voluntary corporate governance initiatives. Some reports suggest alternative methods on how to consider the interests of other stakeholders.²⁹¹ These suggestions include that an industry led corporate responsibility network should be established and that the remuneration of directors should be linked to corporate responsibility.²⁹²

Other legislation relating to the interests of employees, consumers and creditors was also considered.²⁹³ It was found that consumers enjoy adequate protection in other legislation.²⁹⁴ It would seem, however, that employees are not adequately protected.²⁹⁵ Similar to the position in England, directors should consider the interests of creditors when a company is nearing insolvency.²⁹⁶

²⁹⁰ Chapter 3 above.

²⁹¹ Paragraph 4.3 above.

²⁹² Paragraph 4.3 above.

²⁹³ See also ch 2 par 5.2 above where it is indicated that directors should take the protection that stakeholders receive in other legislation into account when managing a company.

²⁹⁴ Paragraph 3.2.5 above.

²⁹⁵ Paragraph 3.2.4 above.

²⁹⁶ See the discussion on the interpretation of this duty of directors to creditors in ch 6 par 3.2 below.

CHAPTER 5

THE LAW OF BOTSWANA

- 1 INTRODUCTION**
 - 2 THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY AND THE HARMONISATION OF CORPORATE LAWS**
 - 3 THE CASE OF BOTSWANA**
 - 4 CONCLUSIONS**
-

1 INTRODUCTION

The Southern Development Coordination Conference was established in 1980.¹ Its main aim was to coordinate development projects in order to lessen economic dependence on South Africa which was, at the time, governed by an apartheid government. More specifically, its aims included decreasing economic dependency, especially on South Africa, creating regional integration, mobilising local resources and ensuring international cooperation.²

In August 1992 the organisation was transformed and the Southern African Development Community (SADC) was formed.³ The SADC Treaty was signed in Windhoek on 17 August 1992.⁴ Article 6 of the treaty places an obligation on member states to adopt measures to promote the achievement of SADC's objectives. The treaty aims to give effect to this objective through a series of protocols.⁵ The protocols set out principles and procedures under which member states will co-

¹ In Lusaka, Zambia. The founding member states were Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

² Henning & Du Toit "Financial Markets in the Southern African Development Community" 41.

³ Hereafter SADC. The current member states are Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

⁴ Hereafter the SADC Treaty (www.iss.co.za/pubs/monographs/No43/TheTreaty.html (accessed 20 June 2006)).

⁵ Article 22 of the SADC Treaty.

operate in specific areas.⁶ The treaty can therefore be seen as a declaration of intent, rather than a firm agreement.⁷ The SADC objectives include achieving development and economic growth, alleviating poverty, enhancing the standard and quality of life of people in southern Africa, and supporting the socially disadvantaged through regional integration, to evolve political values, systems and institutions, and to achieve complementarity between national and regional strategies and programmes.⁸

The ultimate objective is to build a region in which there will be a high degree of harmonisation. SADC is therefore the most important mechanism or body when it comes to the promotion of economic co-operation in southern Africa.⁹

Member states must harmonise, rationalise and coordinate their policies and strategies for sustainable development in line with the treaty. The treaty commits member states to principles of sovereign equality, peace, security, human rights, equity, balance and mutual benefit.¹⁰ The member states should indicate their commitment to act in accordance with these principles. SADC's vision is now one "of a common future, within a regional community that will ensure economic well-being, improvement of the standards of living and quality of life, freedom and social justice and peace and security for the peoples of Southern Africa".¹¹

The principal institutions of SADC are: the Summit, the Troika, the Council of Ministers, the Standing Committee of Senior Officials, SADC National Committees, the Secretariat, the Organ on Defence, Politics and Security Cooperation and the Tribunal.¹²

⁶ www.zuidafrika.nl/politics (accessed 20 June 2006).

⁷ Henning & Du Toit "Financial Markets in the Southern African Development Community" 43.

⁸ Article 5 of the SADC Treaty; www.sadc.int (accessed 20 June 2006).

⁹ Henning & Du Toit "Financial Markets in the Southern African Development Community" 42.

¹⁰ Article 4 of the SADC Treaty.

¹¹ www.sadcreview.com/sadc/sadc_profile (accessed 11 June 2006).

¹² Article 9 of the SADC Treaty. The Summit is the ultimate policy-making institution. The Troika consists of the Chair, the Incoming Chair and the Outgoing Chair. The Council of Ministers consists of Ministers from each member state, usually the Minister of Foreign Affairs. The Council should

As already mentioned, the aims of the treaty are given effect by means of various protocols. SADC operates through a system of sectoral responsibilities. Each member state assumes responsibility for the promotion and attainment of certain goals in a specific sector. South Africa has been assigned with the portfolio of finance and investment. Harmonisation of stock exchange listing requirements and central banking regulation has already taken place.¹³ However, no initiatives are yet under way in respect of the harmonisation of the corporate laws of the various SADC countries.¹⁴

The Office of the Legal Affairs Unit was established in February 2002. This unit was established to assist member states to harmonise their laws in areas such as trade, commerce, finance and labour.¹⁵

oversee the functioning and development of SADC, ensuring that the policies are properly implemented. The Standing Committee of Officials is the technical advisory committee to the Council. The National Committees should provide inputs at the national level when regional policies and strategies are formulated. The Secretariat is the principal executive institution of SADC and its members are responsible for strategic planning, co-ordination and management of SADC programmes. Priorities for the Secretariat are based on how they can best achieve the objectives of SADC. These priorities include: trade, finance and investment, stakeholder participation and policy, formulation and harmonisation. The Organ on Defence, Politics and Security Co-operation promotes peace and security in the region. The Tribunal will ensure proper interpretation of the provisions of the SADC Treaty. See Arts 10–16 of the SADC Treaty, and the profile of SADC at www.sadc.int (accessed 20 June 2006).

¹³ On 8 October 1999 a press statement was released announcing that the listing requirements of stock exchanges in Botswana, South Africa, Malawi, Namibia, Zambia and Zimbabwe have been harmonised. The 13 principles set out in the listing requirements of the JSE Limited have been applied. Harmonisation relating to the regulation of central banks has also taken place. See Henning & Du Toit “Financial Markets in the Southern African Development Community” 46.

¹⁴ Henning & Du Toit “Financial Markets in the Southern African Development Community” 45–46, 67. The Department of Trade and Industry has embarked on a programme dealing with the harmonisation of business laws in Africa. The objective of harmonisation of business laws in Africa is to facilitate business activity and transactions at relatively low costs. A workshop was held in December 2006 in Tshwane, South Africa and it was stated that the way forward is to establish a standing committee on the harmonisation of business laws in Africa. The committee should consist of member states of the African Union. No further information on this programme is available.

¹⁵ The *Protocol on Legal Affairs* is available at http://www.iss.co.za/AF/RegOrg/unity_to_union/SADC.html dated 7 August 2000 (accessed 20 June 2006).

2 THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY AND THE HARMONISATION OF CORPORATE LAWS

It has already been mentioned that harmonisation of South African corporate law with the laws of international investors and other southern African states is very important.¹⁶ It is especially important to consider the laws in SADC countries, because their circumstances are similar to those in South Africa.¹⁷ SADC and its objectives were discussed in general above. The developments in the company law of Botswana, as an example of a SADC country, are investigated below.

The format of this chapter differs from the United Kingdom, Australian and South African chapters. The aim of this chapter is to provide another African perspective, apart from South Africa, on stakeholder protection. The focus is on SADC's aim of harmonisation. An appraisal is conducted on whether or not Botswana went against SADC's goal of harmonisation in southern African states by applying New Zealand company law instead of English law.

African states have diverse legal systems, usually classified according to a common law family, a continental European civil law family or a mixed legal family. Nigeria, Ghana and Kenya are examples of common law families and Togo of the civil law family.¹⁸ Former French or Belgium colonies usually fall within the civil law family. Most Southern African countries have mixed jurisdictions, being a combination of common law and Roman-Dutch law. The existence of these different legal families in Africa have the advantage that it should be possible to harmonise the laws of certain African states according to the specific system followed, thus facilitating regional harmonisation.¹⁹

¹⁶ Havenga "Regulating Directors' Duties" 609.

¹⁷ The *Policy Document* ch 3 par 3.5.

¹⁸ Bamodu "Transnational Law" 127.

¹⁹ Bamodu "Transnational Law" 125–135. The SADC process is an attempt to harmonise the laws of countries in southern Africa. West and Central African Countries signed OHADA, a French acronym for the Organisation for Harmonisation of Business Law in Africa. This is an attempt to harmonise the laws of traditional civil law family countries, specifically business law (www.mpmagazine.com (accessed 20 June 2006)).

The February 2005 *NEDLAC Report* states:²⁰

If there is a need for harmonization with company law in other countries, it should be limited to those jurisdictions that are closely aligned/approximated to that of South Africa, and to those countries which provide a significant source of investment to South Africa...

This chapter therefore focuses on corporate law harmonisation between southern African states and other African states are not considered.

Harmonisation in the context of international law relates to the process by which different states adopt the same laws. Laliberte states:²¹

Virtually by definition, commercial legislation is focused on regulating business activities within a given country. When the type of legislation varies to some degrees [*sic*] from one country to another within a region, it generally ensues that relationships may become more complex for enterprises doing business in more than one country. This is why it would be beneficial to create a business law model with the objective, through a harmonisation process, of facilitating compliance with legal requirements throughout the region and thus promote and facilitate trade and investment in the region, both regionally and internationally.

The company laws in most of the southern African states are based on English law. This makes the aim of harmonisation more achievable.²² However, as was pointed out above, such harmonisation has not yet taken place.²³

Henning points out that a number of issues need to be addressed when attempting to harmonise company laws. These issues include the maintenance of share capital, the transferability of shares, the protection of minority shareholders, the structuring of company groups, takeovers and mergers, worker participation on the boards of

²⁰ See *February 2005 NEDLAC Report* par 6.3.8.

²¹ Laliberte (1999) in Henning & Du Toit “Financial Markets in the Southern African Development Community” 47.

²² Bamodu “Transnational Law” 133.

²³ The SADC *Programme for Regional Harmonisation of the Accountancy Profession* of 1998 included harmonisation of the business laws of the SADC region, but this has not yet taken place. See Henning & Du Toit “Financial Markets in the Southern African Development Community” 47.

companies, and the duties and responsibilities of the management board or board of directors of a company.²⁴ This discussion only focuses on directors' duties, especially in whose interests they should manage a company and whether or not their duties should be codified.

Despite the obvious need for harmonisation and the objectives of the treaty, various SADC countries are conducting their own review processes. The result of some of these reviews has been to deviate from the English common law, which could make eventual harmonisation even more difficult. This could arguably be seen as a violation of the duties of the member states in terms of the treaty.²⁵

Botswana is one of the countries that has recently reviewed its company laws, resulting in a new Companies Act of 2003.²⁶ Other countries also conducted reviews, but they have not yet resulted in new company legislation.²⁷ The developments in Botswana are therefore discussed in more detail below.

²⁴ Henning & Du Toit "Financial Markets in the Southern African Development Community" 48.

²⁵ See Art 6 of the SADC Treaty, which provides that "member states undertake to adopt adequate measures to promote the achievement of the objectives of SADC, and shall refrain from taking any measure likely to jeopardise the sustenance of its principles, the achievement of its objectives and the implementation of the provisions of this Treaty". Art 33 of the SADC Treaty also provides that "sanctions may be imposed against any member state that persistently fails, without good reason, to fulfil obligations assumed under this treaty or implements policies which undermine the principles and objectives of SADC".

²⁶ This Act came into force on 3 July 2007, see n 57 below.

²⁷ For example, Swaziland. The current Swaziland company legislation dates back to 1912 (see the Companies and Associations Act 7 of 1912). This Act is still applicable. Their commercial legislation is therefore outdated and in many aspects not sufficient for the modern businessman. Recognition of the need for corporate law reform in Swaziland is not new. In 1977 a commission was set up to investigate the commercial law regime in Swaziland, but no formal report was issued. In 1988 another effort was made, but the work of the 1988 committee received almost no publicity and its sittings were not public. In 1997 Prof J Kiggundu of the University of Botswana was appointed as a consultant to review the 1912 Act. He produced an Interim and Final Report as well as a Draft Companies Bill in 2001. The process is, however, still ongoing. See Baloro "Corporate Law and National Development" 130–133; Kiggundu "Modern Company Law" 130.

3 THE CASE OF BOTSWANA

3.1 The Company Law Review Process: An Overview

3.1.1 Introduction

In 1885 Britain proclaimed a protectorate over Bechuanaland (today known as Botswana). The Bechuanaland Protectorate was formally established in 1891. The law of the Cape Colony (which was under British occupation) was applied and became the law of Botswana. Botswana company law was mainly based on English law. In 1934 it was realised that these laws were not suitable for Botswana. The government secretary suggested that it should be replaced with more modern legislation. The crown prosecutor then drafted the first Bechuanaland company law. It was largely based on the Companies Act of the South African Union.²⁸ This company law was also viewed as inadequate and in 1959 a draft Proclamation was issued.²⁹ Its aim was to establish a more modern and comprehensive company law, based on English company law (the Companies Act of 1948), but suited to the circumstances of the specific territory. The draft proclamation was modelled on the Southern Rhodesia³⁰ Companies Act of 1951 which, in turn, was modelled on the Companies Act of 1948 of England. The draft Proclamation was passed as the new Companies' Proclamation in April 1959.³¹ The Companies' Proclamation then became the Companies Act of 1959.³² This Act has been amended several times; for the last time in 1995.³³

²⁸ Act 46 of 1926.

²⁹ The Proclamation was amended in 1961 by the Companies (Amendment) Act 8 of 1961.

³⁰ Now Zimbabwe. The South Rhodesian Companies Act was amended by the Companies (Southern Rhodesia) Amendment Act 20 of 1959.

³¹ Laws of Bechuanaland Protectorate, Proclamation 71 of 1959.

³² Laws of Botswana ch 42:01.

³³ Act 7 of 1995 (hereafter the Companies (Amendment) Act of 1995). See Kiggundu "Company Law Reform in Botswana" 496–499 for a complete discussion of the history of Botswana company law. He also discusses the amendments that the 1995 Act brought about in detail. See also Kiggundu "Botswana" 23–25.

The 1995 amendments were not a comprehensive reform of the company laws of Botswana, but they brought about interesting changes that had profound effects on Botswana company law.³⁴ Disclosure and transparency were the main themes of the amendments. The most important amendments relate to the strengthening of the office of the Registrar, clarifying his duties and functions, reforming the rules on capital maintenance and introducing new requirements relating to company directors and secretaries.³⁵

These amendments effected only piecemeal changes to the company legislation in that jurisdiction. Kiggundu advocated for a complete review of the company law in Botswana.³⁶ In 1999 Professor Peter McKenzie was appointed as a consultant to review Botswana company law.³⁷

McKenzie first issued an *Interim Report*³⁸ on the Botswana Companies Act followed by a *Final Report*.³⁹

³⁴ Kiggundu “Company Law Reform in Botswana” 496.

³⁵ Sections 2, 14, 66–71.

³⁶ Kiggundu “Company Law Reform in Botswana” 496; see also Kiggundu “Modern Company Law” 101.

³⁷ Peter McKenzie is an eminent expert in company law in New Zealand. During a meeting with him in New Zealand during April 2007, he kindly provided me with the following documents: The *Interim Report on the Review of the Botswana Companies Act* (18 March 1999) (hereafter the *Interim Report*) drafted by himself; commentary on the Companies Bill received by Michael Letsogile Mothobi from the University of Botswana (undated) (his comments are mainly on the draft provisions concerning company types and forms, on the application of the Act and on the transitional provisions and not on directors’ duties); commentary received from Neil Armstrong of the Law Society of Botswana (May 2000) and McKenzie’s response thereto and A *Review on the Final Report on the Review of the Botswana Act* drafted by Matheson Ormsby Prentice from Dublin (9 March 2000) (this review document dealt mainly with the question of regulation and the protection of shareholders and the public rather than with the structure of companies. Directors’ duties were not discussed in this review document). The *Final Report on the Review of the Companies Act* (3 November 1999) (hereafter the *Final Report*) on which the review of Mr Prentice was based was compiled by McKenzie. The draft Companies Bill was attached to this report. A copy of this report was kindly provided to me by Prof Kiggundu.

³⁸ The Draft Companies Bill of Botswana has been prepared on the basis of this *Interim Report*. The recommendations contained in this report were put forward at a seminar held in Gaborone on 21 April 1999.

³⁹ It is important to discuss both the *Interim* and the *Final Reports*, because the *Interim Report* was more detailed.

In the *Interim Report* of March 1999 a brief background statement is provided on the current Botswana Companies Act,⁴⁰ followed by the approach taken in reviewing the Act as well as a detailed statement on the main areas of reform.⁴¹

During the initial discussions, McKenzie canvassed two possible options concerning the approach to be taken with the reform process. The first option was to update the provisions of the current Act, but to retain that Act as far as possible. The second option was to introduce a completely new Act which presented a straightforward restatement of the law, without having to replicate the language or structure of the present Act. The interested parties opted for the second option. The idea was therefore to carry out a thorough review of the Act, but not to change the current law if not necessary.⁴²

It was stated in the *Interim Report* that cognisance had to be taken of certain issues when reforming the Companies Act of Botswana. These issues included the substantial increase in commercial activity in Botswana since the introduction of the Botswana Companies Act of 1959; the need to update the current legislation by having regard to the changes in the commercial practice of Botswana and the comparable changes that had been introduced in other countries with an English-based system of company law. The desirability of creating an efficient legal and regulatory framework in order to facilitate domestic activity and encourage foreign investments was also important. Botswana's membership of SADC was also mentioned as important, because the company law regime adopted in Botswana should be compatible with the laws of other jurisdictions in the SADC region.⁴³ The revised Companies Act would therefore seek to be up to date, remove impediments that would hamper business activities, and clarify and simplify the law.⁴⁴

⁴⁰ See the discussion on the background of the Companies Act of 1959 (hereafter the Companies Act of 1959) below.

⁴¹ Paragraphs 1–2 of the *Interim Report*.

⁴² See par 6 of the *Interim Report*.

⁴³ Whether or not Botswana, in fact, adopted a regime that is compatible with other SADC country's company law regimes is discussed below. See par 7 of the *Interim Report*.

⁴⁴ See par 8 of the *Interim Report*.

In paragraphs 10–16 of the *Interim Report* the appropriate company law model for Botswana is discussed. These paragraphs are very important in view of the discussion below on whether or not Botswana went against SADC’s goal of harmonisation by mainly applying the law of New Zealand instead of the traditional English law. First it is stated that various jurisdictions based on English law reviewed their company legislation in the past 40 years. These countries include Canada, the United Kingdom, Australia and New Zealand.⁴⁵ The Australian Uniform Companies Act of 1961 provided an improved version of the English Companies Act of 1948. This improved version was used as a model in various other Commonwealth jurisdictions, such as Mauritius and Hong Kong. These Commonwealth countries have recently examined their company legislation and rejected developments in Australia and the United Kingdom as providing an appropriate model for other jurisdictions. Countries such as Hong Kong and Sri Lanka used the New Zealand Companies Act as a model for adoption in their company legislation. The *Interim Report* suggested that the New Zealand model is simple and straightforward. It provides for a simple form of incorporation of companies, and a more straightforward regime concerning disclosure and accountability of directors. It therefore proposed that the New Zealand model be used as a basis for the new Companies Act of Botswana, but that it should be adopted to suit their local needs.⁴⁶

The *Interim Report* then discusses and makes recommendations relating to small and medium enterprises, the Registrar of Companies and the administration of insolvent companies.⁴⁷ This is followed with an outline provided on the main proposed changes. The section dealing with directors’ duties is important.⁴⁸ It points out that there was no comprehensive statement of directors’ duties in the English Companies

⁴⁵ South Africa is another example of a country that reviewed its company law during this period.

⁴⁶ Since its inception in 1860 New Zealand company law was also modelled on English company law, but rather followed the Canadian model when they reformed their company law in 1993. See generally on the history of New Zealand law Du Plessis “Some International Developments” 226–227; Morison *Morison’s Company Law New Zealand* ch 1.

⁴⁷ Paragraphs 21–41 of the *Interim Report*.

⁴⁸ Paragraphs 42–132 of the *Interim Report*.

Act of 1948.⁴⁹ Such a statement would, however, assist directors when exercising their duties. It is suggested in the *Interim Report* that the statement on directors' duties in the Mauritius Companies Act of 1984 is a useful example,⁵⁰ due to the balance that it creates between the need not to discourage enterprise and initiative on the part of directors, but also to provide protection against misuse by directors of their powers for personal advantage.⁵¹ It was therefore recommended that the new Companies Act contain a statement of directors' duties.⁵²

The *Final Report* on the company law review process in Botswana was issued in November 1999. The introduction to the *Final Report* states that the proposed Companies Act provides a new restatement of company law for Botswana. It is recommended that the New Zealand Companies Act of 1993 be adopted as the model for the new company law legislation in Botswana, but adapted to the local needs and infrastructure of Botswana.⁵³ The Act should also be compatible with corresponding provisions in South African and Zimbabwean company legislation.⁵⁴ The remainder of the *Final Report* deals with significant changes to company law in Botswana. These changes include the abolition of the doctrines of *ultra vires* and constructive notice, the abolition of the concepts of par value shares and nominal capital and provides for a comprehensive statement of directors' duties.⁵⁵ For purposes of this thesis the comprehensive statement of directors' duties and powers is particularly important.⁵⁶

⁴⁹ This is also currently the position in South Africa.

⁵⁰ Sections 102–103 of the Mauritius Companies Act 57 of 1984. This Act is largely based on the United Kingdom Companies Act of 1948 available at www.gov.mu/portal/gov/compdiv/file (accessed 16 November 2007).

⁵¹ See s 160(2) on the duty of a director to disclose, in writing, all the matters concerning the affairs of the company relating to him personally.

⁵² Paragraphs 75–77 of the *Interim Report*.

⁵³ This is in line with the approach proposed in the *Interim Report*.

⁵⁴ Paragraph 2.1 of the *Final Report*. This is in line with the goal of SADC, namely the harmonisation of business laws in southern African countries, as discussed above.

⁵⁵ Paragraph 3.1 of the *Final Report*.

⁵⁶ Sections 130–133; 158 of the Companies Act of 2003.

McKenzie's recommendations led to the Companies Bill of 2001, which was enacted as the Companies Act of 2003.⁵⁷

This Act demonstrates a radical departure from the English model, which was previously applicable in Botswana.⁵⁸ Some of the most prominent features of the Companies Act of 2003 are the introduction of a simplified procedure for the incorporation of a company;⁵⁹ the abolition of the *ultra vires* doctrine and the doctrine of constructive knowledge;⁶⁰ the abolition of the concepts of par value shares and nominal value;⁶¹ requirements regarding the disclosure of the beneficial ownership in shares in the case of a public company;⁶² and providing for modern procedures relating to the winding-up of a company.⁶³ The Companies Act of 2003 introduced a modern and comprehensive code of directors' duties. It also regulates directors' self-dealing transactions and the disclosure of their interests.

3.1.2 Directors' Duties

As background and to understand the changes that the 2003 Companies Act brought about, a brief discussion is provided on the 1959 Companies Act in the next section. Thereafter the relevant provisions in the 2003 Act are considered.

⁵⁷ This Act is referred to as the 'Companies Act of 2003'. It was enacted by Parliament on 10 December 2003. It only received presidential assent on 2 September 2004; therefore, it is cited as Act 32 of 2004. This Act took a long time before it came into force, because there were no regulations until June 2007. The Act eventually came into operation on 3 July 2007. For this Act, see Kiggundu *Botswana Company Law*.

⁵⁸ Act 105 of 1993. See par 3.1 of the *Final Report*. See also the discussion above on this issue as dealt with in the *Interim Report*.

⁵⁹ Sections 19–24, 29–44 of the Companies Act of 2003.

⁶⁰ Sections 25–28 of the Companies Act of 2003.

⁶¹ Section 47 of the Companies Act of 2003.

⁶² Section 329 of the Companies Act of 2003.

⁶³ Sections 364–488 of the Companies Act of 2003; Kiggundu "Modern Company Law" 101–103.

3.1.2.1 *The Companies Act of 1959*

It was noted above that this Act was based on the English Companies Act of 1948. The principles applicable to directors' duties in terms of English law⁶⁴ are therefore relevant when interpreting the Companies Act of 1959.⁶⁵

Several provisions in the Companies Act of 1959 were important regarding directors' duties. Every public company had to have at least two directors and every private company at least one. These directors had to be resident in Botswana.⁶⁶ Directors owed their company fiduciary duties, namely the duties of loyalty and good faith and also had duties of care and skill. As a general rule, these duties were owed to the company and not to individual shareholders.⁶⁷

The duty of good faith entailed that directors should display good faith towards the company when dealing on its behalf. The "company" was interpreted as meaning the company as a whole being the shareholders collectively.⁶⁸ This duty of good faith, furthermore, entailed that directors were not allowed to place themselves in a position where there was a conflict between their duties and their personal interests.⁶⁹ This duty was entrenched in legislation, which imposed a statutory obligation on directors

⁶⁴ Traditional English law is relevant when discussing the 1959 Act. British company law has also recently been reviewed and the United Kingdom Companies Act of 2006 is now applicable in England, Scotland, Wales and Northern Ireland (see ch 3 par 4.3 above).

⁶⁵ See also the *Interim Report* where the current Botswana Companies Law, i.e. the Companies Act of 1959 is discussed. It is stated that this Act was based upon the English Companies Act of 1948 and that the Companies (Amendment) Act of 1995 introduced significant changes (see pars 3–5 of the *Interim Report*).

⁶⁶ Section 139 of the Companies Act of 1959.

⁶⁷ See Kiggundu "Botswana" 128–131. He refers to the English decisions of *Percival v Wright* [1902] 2 CH 421 and *Allen v Hyatt* (1914) 30 TLR 444 (PC). The last-mentioned case states that directors may owe fiduciary duties to shareholders individually when they act as their agents. See ch 3 par 3.1.2 above.

⁶⁸ See the following regarding the position in the United Kingdom: *Percival v Wright* at 421; Farrar & Hannigan *Company Law* 380–391; Birds et al. *Boyle & Birds' Company Law* 499; Davies Gower and Davies' *Principles of Modern Company Law* 371–379. These sources are relevant when referring to the Companies Act of 1959 of Botswana because the company law of Botswana was based on the English law, as discussed above.

⁶⁹ Section 156 of the Companies Act of 1959. This statutory rule stated that a director should disclose any personal interests to the board of directors.

to disclose any conflicting interest to the board.⁷⁰ At common law a director was also prohibited from the use of corporate property or information,⁷¹ usurping a corporate opportunity,⁷² unfairly competing with the company and abusing confidence.⁷³ A director further had to exercise an unfettered discretion.⁷⁴

Directors also owed a duty of care and skill to the company. The standard of care and skill that was expected of a director was not very high.⁷⁵

The Companies Act of 1959 also imposed various statutory duties on directors. It was unlawful for a company to pay remuneration to a director free from income tax.⁷⁶ A company was also prohibited from making a loan to a director of that company or its holding company.⁷⁷ It was unlawful for a company to make any payment to its directors by way of compensation for loss of office, without the full particulars of the

⁷⁰ Section 156(2) of the Companies Act of 1959. If the director had a conflicting interest, the board would decide whether the director could enter into a specific contract.

⁷¹ A director could not use a corporate opportunity, property or information to make a secret profit. The company could, however, consent to such a profit being made at a general meeting. Kiggundu refers to the South African case of *Robinson v Randfontein Estates Gold Mining Co* 1921 (AD) 168, where a director was mandated to purchase a farm for the company, but could not agree on the terms with the owner. The owner then promised that if he ever wanted to sell the farm, this director would have first option to buy. The director later bought the farm, but never declared his interest and the profit he made from the transaction to the company. The court held that the company was entitled to recover the profit made by the director. See also Kiggundu “Botswana” 133–134.

⁷² A director was not allowed to take over a contract that was intended for the company. See *Cook v GC Deeks* [1916] 1 AC 554 (PC). See Kiggundu “Botswana” 134–135.

⁷³ A director could become a director of a rival company, but he was not allowed to subordinate the interests of the first company to those of the second: Kiggundu “Botswana” 135.

⁷⁴ Directors were not allowed to fetter their discretion. They could not contract on how they should vote in future board meetings. See also Kiggundu “Botswana” 136.

⁷⁵ See Kiggundu “Botswana” 137, where he refers to the English case of *Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 (CA) due to the 1959 Act being based on English company law. There was no provision regulating the obligations of care, skill and diligence in the Companies Act of 1959.

⁷⁶ Section 146(1) of the Companies Act of 1959.

⁷⁷ Section 147(1) of the Companies Act of 1959. There were three exceptions to this general rule, see Kiggundu “Botswana” 139; ss 139–159 of the Companies Act of 1959 relating to: “Directors: Position and Duties”. There were also statutory provisions concerning directors’ compensation for loss of office, (s 148 of the Companies Act of 1959) and provisions aimed at ensuring transparency in directors’ dealings in company shares and debentures, (s 152(1) of the Companies Act of 1959). See also Kiggundu & Havenga “The Regulation of Directors’ Self-Serving Conduct” 272–293.

payment being disclosed to the members of the company and approved by the general meeting.⁷⁸ Directors' interests in company securities were also regulated in the Act. Botswana companies had to keep a register showing the number, description and value of any shares or debentures of the company or any subsidiary or holding company within a group of companies, held by or in trust for each director.⁷⁹ A director of a public company had to disclose to the board the number and class of shares in which he held an interest as well as the nature of such interest.⁸⁰

The 1959 Companies Act did not provide for a codification of directors' duties. The duties of directors were entrenched in the common law, case law and legislation. The common law viewpoint prevailed, namely that directors should manage the company in the best interests of the company as a whole, namely the shareholders collectively.⁸¹ The provisions in this Act concerning directors' duties were in line with the current South African company law.⁸²

3.1.2.2 *The Companies Act of 2003*

The 2003 Companies Act brought about several changes to the previous company legislation. The most important change, for the purposes of this thesis, is the comprehensive statement of directors' duties.⁸³ Kiggundu indicates that many

⁷⁸ Section 148 of the Companies Act of 1959.

⁷⁹ Section 152(1) of the Companies Act of 1959.

⁸⁰ Section 223(b) of the Companies Act of 1959. See, generally, Kiggundu & Havenga "The Regulation of Directors' Self-Serving Conduct" 272–293.

⁸¹ See also ch 3 par 3.1.1 for a discussion of the position in the United Kingdom. See *Percival v Wright* at 421; Farrar & Hannigan *Company Law* 380–391; Birds et al. *Boyle & Birds' Company Law* 499; Davies Gower and Davies' *Principles of Modern Company Law* 371–379 for the position in the United Kingdom (especially England).

⁸² Chapter 6 par 2.1.1 below.

⁸³ The common law duties are therefore no longer applicable. See Kiggundu "Modern Company Law" 123: "the Companies Bill contains a *comprehensive*, modern codification of directors' duties". (emphasis added). There is also no indication in s 130 of the Botswana Companies Act 2003 that the common law is still applicable. In the South African Companies Bill, however, it is clearly stated in clause 91(6) that "[t]he provisions in this section are in addition to, and not in substitution for, any duties of the director of a company under the common law". See the discussion below (n 99) on whether or not the New Zealand Companies Act of 1993 provides for a comprehensive codification of directors' duties or not. (See generally on this issue, Morison *Morison's Company Law New Zealand* ch 24; Farrar *Corporate Governance* 11).

uncertainties prevailed regarding the duties of directors in terms of the common law.⁸⁴ In order to remove these uncertainties it was necessary to codify directors' duties in clear and simple language. He also suggests that such a codification will create a good balance between directors not misusing their powers, but still being able to take initiative.⁸⁵

Various sections relating to the duties of directors are important. Sections 126–160 regulate the position, powers and duties of directors and company secretaries. Section 126 defines a “director” and the “board”. A “director” is defined as any person occupying the position of director or alternate director of a company, by whatever name he may be called.⁸⁶ “A board” is defined as directors of the company who number no fewer than the required quorum acting together as a board of directors, or if the company has only one director, that director. Section 127 provides that the business of a company shall be managed under the direction or supervision of its board. Section 128 concerns major transactions. A company may not enter into a major transaction or make a substantial gift without approval by way of a special resolution.⁸⁷ Section 129 regulates the delegation of powers. The board of a company may delegate its powers to a committee of directors, a director or an employee of the company, or any other person, subject to any restrictions in the constitution of the company.

Section 130 is of special importance for purposes of this thesis. It confirms the duty of a director to act in good faith and in the best interests of the company. Section 130(5) states specifically that “the duties imposed by this section (130) shall be owed to the company, and not to the shareholders, debenture-holders or creditors of the company”. The section provides a list of directors' duties. These duties include that

⁸⁴ Kiggundu “Modern Company Law” 123. For example, it was uncertain whether or not the general meeting should be allowed to ratify transactions where directors have acted in breach of their duties.

⁸⁵ Kiggundu “Modern Company Law” 123–125.

⁸⁶ Section 2 of the Companies Act of 1959.

⁸⁷ An asset relates to any property of any kind, tangible or intangible and a major transaction means the acquisition of assets whose value is more than half of the value of the company's assets before the acquisition or the disposition of assets whose value is more than half of the value of the company's assets before the disposition (see s 128(2)(a)(b) of the Companies Act of 2003).

directors should exercise their powers in accordance with the Act and within the limits and subject to the conditions established in terms of the constitution of the company.⁸⁸ Directors should obtain the authorisation of a general meeting before doing anything for which such authorisation is required.⁸⁹ Directors should exercise their powers honestly and in the best interests of the company.⁹⁰ They should exercise the degree of skill, care and diligence required in section 158 of the Act.⁹¹ Directors may not use any assets of the company for an illegal purpose,⁹² nor agree that the company take on any obligation, unless they believe at that time, on reasonable grounds, that the company will be able to perform in terms of that obligation.⁹³ Directors must attend meetings of the directors of the company with reasonable regularity.⁹⁴

Since the Companies Act of 2003 is mainly based on the company law of New Zealand, it is useful to consider how the phrase “the company” is interpreted in that jurisdiction and whether or not their company legislation provides for a comprehensive (or exhaustive) or partial codification of directors’ duties.⁹⁵

In terms of New Zealand company law, directors owe a duty to “the company as a whole” to act in good faith and in its best interests.⁹⁶ This is interpreted as meaning

⁸⁸ Section 130(a) of the Companies Act of 2003.

⁸⁹ Section 130(b) of the Companies Act of 2003.

⁹⁰ Section 130(c) of the Companies Act of 2003.

⁹¹ Section 130(d) of the Companies Act of 2003.

⁹² Section 130(j) of the Companies Act of 2003.

⁹³ Section 130(e) of the Companies Act of 2003.

⁹⁴ Section 130(l) of the Companies Act of 2003. “Reasonable regularity” is not defined in the Act. Various other sections in the Act apply to the duties of company directors. Section 159 concerns indemnity and insurance, s 140 relates to the use of company information, s 133 deals with the approval of a company when a director wants to become a director or officer of a competing company. Section 134 provides for the meaning of “interested”, when a director is interested in a transaction to which the company is also a party, s 135 relates to the disclosure of such an interest by a director.

⁹⁵ There are limited academic sources available on Botswana company law. New Zealand company law may therefore provide some guidance on the interpretation of Botswana company law.

⁹⁶ Section 131(1) of the New Zealand Companies Act of 1993 (hereafter the Companies Act of 1993).

that they owe their duties to the shareholders collectively.⁹⁷ However, in certain instances they have a duty to act in good faith towards the company's creditors.⁹⁸

Section 131–149 of the New Zealand Companies Act of 1993 contains a codification of directors' fiduciary duties. There is no provision stating that the common law is still applicable or that it is excluded. Most commentators are of the opinion that the intention was to replace the common law and that these provisions reflect a comprehensive code of directors' duties.⁹⁹ Additional duties may, however, be imposed on directors by way of a contract or in terms of the company's constitution.

If the interpretation of New Zealand sources is used as a basis, it can be said that the new Botswana Companies Act follows the traditional position, namely that directors should manage a company in the best interests of the shareholders collectively. The

⁹⁷ Morison *Morison's Company Law New Zealand* par 24.9. See also The Institute of Directors in New Zealand "Deciding where Best Interest lies for Directors" at www.iod.org.nz/home/articles (accessed 20 April 2007).

⁹⁸ See generally, Morison *Morison's Company Law New Zealand* par 24.8. Case law of Australia and New Zealand is referred to there. This is also discussed in detail in the South African chapter (ch 6 par 3.2).

⁹⁹ Morison *Morison's Company Law New Zealand* pars 23.2, 24.6 (in terms of the New Zealand Companies Bill 1990 clause 116 it was originally intended that the statutory duties of directors be in addition to the common law duties, but the final Act did not provide for this. The Act seems to be a comprehensive set of duties, superseding the common law); Farrar *Corporate Governance* 109, 111 states that it is unclear as to whether the New Zealand law codifies directors' duties, but it does seem that the law is restated and case law occasionally reformed; Watson "Directors' Duties" 495–499 suggests that these provisions seem to represent a comprehensive code of directors' duties, although it is not stated as such in the Act. Even if it is a comprehensive code, the common law will still be relevant in interpreting these provisions at 498, 514; *Re Russley Hotel Ltd; Mattison & Anor v Gough & Ors* (2000) 8 NZCLC 262 (HC) at 399; discussed by Campbell "Does the Companies Act Codify Remedies?" 53, specifically in the context of remedies available for a company in the case of a breach of directors' duties. He also argues that the comprehensive manner in which the code was drafted as well as the absence of a provision preserving the common law is an indication that the code should be treated as exhaustive. See, however, *Manukau City Council v Lawson* [2001] 1 NZLR 599 (HC) where Morris J made the comment that the duties in the Act supplement the common law. See also *Benton v Priore* [2003] 1 NZLR 564 (HC) where Heath J made similar *obiter* comments. He held that it was not the intention of the legislature to codify the duties in ss 130–133 of the Companies Act of 2003, but that they were a restatement of the basic duties of directors in an endeavour to promote accessibility to the law. The possibility of further duties being owed by directors is also not excluded by the Act. See also the *New Zealand Law Commission Report: Company Law Reform and Restatement* No 9 of 1989 par 20 where it is stated that the Act provides for better accessibility to company law by setting up the Act as a statement of *first recourse* in identifying rights and duties within the company (emphasis added). See also *New Zealand Law Commission: Company Law Reform: Transition and Revision* No 16 of 1990 pp xxii–xxiii. The Commission refrained from a recommendation on whether or not the common law is still applicable, but were confident that the courts would recognise a statutory statement of directors' duties as the first recourse when considering these duties.

new Act also provides a comprehensive codification of directors' duties. It seems that courts can still refer to existing case law to interpret the provisions in the code.

3.1.3 SADC's Goal of Harmonisation: Followed or Rejected?

The discussion in this chapter was limited to two issues, namely in whose interests directors should manage a company and the codification of directors' duties.

The position in New Zealand relating to these two issues was considered in order to interpret the provisions in the Botswana Companies Act of 2003. Traditionally, Botswana company law was based on the English common law. The drafters of the new Botswana Companies Act deviated from English law and applied the company law of New Zealand. This could lead to concern, especially if one keeps the goal of SADC in mind, namely the harmonisation of business laws in southern African states, seeing that most of the corporate laws of southern African states are based on the English common law. Applying New Zealand company law, instead of English law, seems to defeat this purpose.¹⁰⁰ It is therefore important to understand the position in the United Kingdom¹⁰¹ to determine whether Botswana went against SADC's goal of harmonisation. In chapter 3 of this thesis the United Kingdom's viewpoints on these two issues were discussed

It was argued that after considering New Zealand sources on the stakeholder debate and the codification of directors' duties, one can conclude that the Botswana Companies Act of 2003 is in favour of directors managing the company in the best interests of the company, namely the shareholders collectively. The Botswana Companies Act also provides for a comprehensive statement of directors' duties. This does not, however, imply that the courts will no longer refer to the common law when interpreting the statutory duties of directors.¹⁰²

¹⁰⁰ It is important to note that the importance of SADC and its goal of harmonisation was referred to in the *Interim Report* (at par 7), as discussed above. See also par 3.1.1 above on why the drafters followed the New Zealand law.

¹⁰¹ The new Companies Act of 2006 is applicable in England, Scotland, Wales and Northern Ireland, unlike the Companies Act of 1985 which only applied in England and Wales.

¹⁰² See n 99 above on how New Zealand commentators interpret the codification of directors' duties.

When considering the United Kingdom Companies Act in chapter 3, it was concluded that it was similar to the position in New Zealand (and thus Botswana) on these two issues.¹⁰³ The position in Botswana is therefore not significantly different from the position in the United Kingdom. Both the Botswana Companies Act of 2003 and the United Kingdom Companies Act of 2006 state that directors should manage a company in the best interests of the company, upholding the traditional (common law) viewpoint that the shareholders receive primacy when directors manage a company.¹⁰⁴ The Botswana Companies Act of 2003 provides for a comprehensive statement of directors' duties. Company law in the United Kingdom was also reviewed and the Companies Act of 2006 now provides for an exhaustive statement of directors' duties. "Exhaustive" is interpreted as indicating that courts cannot develop new principles concerning the general duties of directors, but they can develop the existing principles by referring to particular cases and the common law.¹⁰⁵ Commentators in New Zealand also suggested that judges can take the common law into consideration when interpreting the statutory duties of directors.¹⁰⁶

South Africa is also a member of SADC. One therefore needs to determine whether the proposed new company legislation in South Africa is compatible with the Botswana company law set out above and *vice versa*. The Draft Companies Bill¹⁰⁷ partially codifies¹⁰⁸ directors' duties.¹⁰⁹ The Bill is, however, unclear on the preferred

¹⁰³ Chapter 3 par 4.3 above.

¹⁰⁴ See s 130(c) of the Companies Act of 2003 and s 172(1) of the United Kingdom Companies Act of 2006. Section 172(1) is, however, drafted in wider terms than s 130(c). Section 172(1) refers to specific stakeholders, but it seems, as if s 172(1) still prefers the traditional viewpoint, as stakeholders cannot enforce the rights contained in s 172(1). This is discussed in detail in ch 3 par 4.3 above. See Keay "Section 172(1)" 106–110 for a detailed discussion of s 172 of the United Kingdom Companies Act of 2006.

¹⁰⁵ As seen from ch 3 par 4.3 above. See *Developing the Framework* pars 3.20; 3.82; *Completing the Structure* pars 3.2; 3.6; 3.12 and the *White Paper 2005* par 3.3.

¹⁰⁶ See n 99 above.

¹⁰⁷ February 2007.

¹⁰⁸ Chapter 4 of the Bill provides for a codified regime of directors' duties, which includes the fiduciary duty and the duty of reasonable care. This codification is only partial as the common law duties still apply. See the *Explanatory Memorandum of the Bill* (annexed to the Draft Companies Bill of 2007) p 13. See ch 6 par 5.5 for a discussion of the codification in terms of South African law.

¹⁰⁹ See clauses 91; 92; 92A of the Bill.

approach concerning the protection of the interests of stakeholders.¹¹⁰ It seems, at this stage, that the only difference between Botswana company law and South African company law concerning the stakeholder debate and the codification of directors' duties is the fact that South Africa has a partial codification and Botswana a comprehensive one. The differences between a partial codification and a comprehensive codification are not necessarily that significant. The common law will still be relevant in terms of a comprehensive codification as judges will rely on it to interpret the provisions in the code.¹¹¹ It is also assumed that a comprehensive code is comprehensive in the real sense of the word and contains the common law duties in any event.¹¹²

4 CONCLUSIONS

This chapter focused on SADC and its goal of harmonisation in southern African States.¹¹³ Harmonisation, in this context, relates to the process by which different states adopt the same laws.¹¹⁴ It was stated that most southern African states company laws are based on English law making eventual harmonisation easier.¹¹⁵ Botswana is an example of a southern African country who reviewed its company legislation recently.¹¹⁶ The new Companies Act of Botswana is, however, based on the New Zealand, and not English, company legislation. It was argued that this seems like a

¹¹⁰ See clause 91(b). See ch 6 par 4.3 for comments on this clause.

¹¹¹ Watson also argued this in "Directors' Duties" 495–499. Australian company law also indicates that there is not really such a big difference between a comprehensive and partial codification of directors' duties. There was no case law based on common law duties the past years in Australia. All of the cases were based on one of the statutory provisions in the Act. Du Plessis et al. *Principles of Contemporary Corporate Governance* 259 argue that the statutory duties are far more important than the duties at common law or in equity. See also Abernethy & Weir *Anderson's Company & Securities Law* at 8.

¹¹² The position in South Africa concerning the protection of stakeholders and the codification of directors' duties are discussed in detail in chapter 6 par 4; 5 below.

¹¹³ Paragraph 2 above.

¹¹⁴ Paragraph 2 above.

¹¹⁵ Paragraph 2 above.

¹¹⁶ Paragraph 3 above.

contravention of SADC's goal of harmonisation. But when the New Zealand Companies Act was compared with the United Kingdom Companies Act and the South African Companies Bill, it was found that there are no major discrepancies with regard to stakeholder protection and the codification of directors' duties. The Botswana's Companies Act of 2003 (based on the position in New Zealand), the United Kingdom's Companies Act of 2006 and the South African Companies Bill of 2007¹¹⁷ state that directors should manage the company in the best interests of the company. All of the aforementioned Acts¹¹⁸ and the Bill provide for a codification of directors' duties, subject thereto that the South African Companies Bill only provides for a partial codification whereas the Companies Act of Botswana and the Companies Act of the United Kingdom provide for a comprehensive statement of directors' duties.¹¹⁹

Botswana's company law is therefore in line with the reformed English company law on these specific areas of company law. The threat of Botswana going against SADC's goal of harmonisation by applying the law of New Zealand is therefore not valid regarding these issues. The Botswana Companies Act and the South African Companies Bill are also not significantly different concerning the protection of stakeholders and the codification of directors' duties.¹²⁰ This is important in the SADC context, as both Botswana and South Africa are member states.

The successful review of company law in Botswana is commendable. Apart from South Africa, it is one of the few southern African states that have concluded a successful review process.

¹¹⁷ Although it is not sufficiently clear in terms of the Bill (see ch 6 par 4.3).

¹¹⁸ Except for the current South African Companies Act.

¹¹⁹ See ch 6 par 5.2 for a detailed discussion of the advantages and disadvantages of a codification (partial or comprehensive) of directors' duties

¹²⁰ Paragraph 3.1.3 above.

CHAPTER 6

SOUTH AFRICAN LAW

- 1 INTRODUCTION**
 - 2 DIRECTORS' DUTIES**
 - 3 THE VARIOUS STAKEHOLDERS**
 - 4 THE STAKEHOLDER DEBATE: APPROACHES FOLLOWED IN THE KING REPORTS, THE POLICY DOCUMENT AND THE COMPANIES BILL OF SOUTH AFRICA**
 - 5 CODIFICATION OF DIRECTORS' DUTIES**
 - 6 CONCLUSIONS**
-

1 INTRODUCTION

The South African Companies Act of 1973¹ applies to all companies incorporated in terms of the Act. This Act is largely based on the English law.² The Act is not a complete codification of company law and common law principles also apply.³

The last comprehensive South African company reform was 1963 by the Van Wyk De Vries Commission.⁴ This process led to the enactment of the Companies Act, which was still mainly based upon English company law.⁵ There are increasing differences between South African and English company law, mainly as a consequence of the harmonisation of laws of the various European Union countries.⁶

¹ Act 61 of 1973.

² Cilliers & Benade *Corporate Law* 17–19; Fourie “Vertrousenspligte” 119.

³ Havenga *Fiduciary Duties of Company Directors* 303; Havenga “Regulating Directors’ Duties” 610.

⁴ Fourie “South African Corporate Law Reform” 770. See the *Van Wyk de Vries Commission (Kommissie van Ondersoek na die Maatskappywet Hoofverslag RP 45/1970 and Aanvullende Verslag en Konsepwetsontwerp RP 31/1972)*.

⁵ Mongalo “South Africanizing Company Law” 96.

⁶ See ch 3 focus on United Kingdom company law, especially the United Kingdom Companies Act of 2006. See also the discussion on the harmonisation of business laws in SADC countries, ch 5 par 3.1.3.

In addition, the constitutional framework post 1994 established a new political, social and economic environment for South Africa and necessitated a complete review of corporate laws.⁷ Developments in the field of corporate governance also contributed to the need for a complete review of corporate laws.⁸ Company law should be up to date, competitive and designed for a modern corporation that can operate in a constitutional environment as well as on an international level.⁹

In 1994 an international conference was held to identify key areas requiring review.¹⁰ In 1997 the Standing Advisory Committee on Company Law¹¹ issued a discussion document, through the South African Department of Trade and Industry, entitled: “Proposed Guidelines for Competition Policy”,¹² which outlined a broad legislative review process on the development of entrepreneurial law in South Africa. This process included a review of current practices and regulations in the area of corporate governance.¹³ Since the publication of these guidelines *King II*¹⁴ has been issued.¹⁵

⁷ Section 39(2) of the Constitution states that every court, tribunal or forum should promote the spirit, intent and objectives of the Bill of Rights when they develop the common law. The evaluation of statutory and common law rules against constitutional principles are of the utmost importance. Corporate laws should therefore be evaluated against the Constitution. See Havenga “Regulating Directors’ Duties” 612–613; Havenga “Directors’ Fiduciary Duties Under our Future Company-law Regime” 312; Havenga “Corporations and the Right to Equality”. Section 8(2) of the Constitution states that a provision of the Bill binds a natural or juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of the duty imposed by the right and it grants a court the right, when applying the provisions of the Bill, to: “apply, or if necessary to develop, the common law to the extent that legislation does not give effect to that right, and to develop rules of the common law to limit the right, provided that the limitation is in accordance with the limitation provisions of the Bill”.

⁸ The publication of *King I* and *King II* are important corporate governance developments in South Africa. Compliance with these reports is voluntary, but some of its provisions are enforced in the *JSE Securities Exchange’s Listing Requirements*, for example, that the chief executive officer could not also be the chairperson of the board, see par 3.84. See Havenga “Regulating Directors’ Duties” 612 n 14; Hippert “Compliance with the King Code” 86. A *King III Report* is expected to be published in 2010.

⁹ The *Policy Document*, foreword.

¹⁰ Havenga “Regulating Directors’ Duties” 610.

¹¹ A Standing Advisory Committee was established in terms of s 18 of the Companies Act of 1973. The committee makes recommendations from time to time regarding amendments to company law.

¹² Dated 27 November 1997. Available at www.polity.org.za/html/govdocs/polity/competition.html.

¹³ It envisaged five main statutes, namely a redrafted Companies Act, a separate Securities Act (dealing with the raising of capital and the obligation to issue and register prospectuses), the Close Corporations Act 69 of 1984 (hereafter the Close Corporations Act), a new Bankruptcy Act (dealing with insolvency and judicial management), and a new Business Enterprises Act (focusing on

It was clearly time for a comprehensive review of South African company law that would also consider the effect of the Constitution on further developments in corporate law. The Corporate Regulation Division of the Department of Trade and Industry responded to this need with the commencement of the pending reform of national corporate laws. In 2004 a policy document on the guidelines for corporate law review was issued.¹⁶ The document envisaged an overall review of corporate laws in South Africa, comprising the Companies Act 61 of 1973, the Close Corporations Act 69 of 1984 and the common law relating to these corporate entities.¹⁷

The objective of the review process is to ensure that company law in South Africa is in line with social, economic and legal¹⁸ developments.¹⁹ According to the drafters of the *Policy Document*, new company law should promote competitiveness and development of the South African economy. New company law should do the following: encourage entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing the costs associated therewith; promote innovation and investment in South African markets by providing a predictable and regulatory environment and flexibility in the formation of the management of companies; promote the efficiency of companies and their management; encourage transparency and high standards of corporate governance; recognise the broader

partnership law and the law of business trusts). See Havenga “Regulating Directors’ Duties” 610; Cilliers & Benade *Corporate Law* 23–28; Henning “The Future of Entrepreneurial Law” 58–88 where he discusses the five principal statutes plan.

¹⁴ See par 4.1 below for a discussion of *King II*.

¹⁵ See the Foreword and the Introduction of the *Policy Document*. See also Havenga “Regulating Directors’ Duties” 610.

¹⁶ May 2004.

¹⁷ The review does not include partnership law. There is therefore some deviation from the initial five principle statutes plan, see Havenga “Regulating Directors’ Duties” 611.

¹⁸ For instance, the Black Economic Empowerment Act 53 of 2003; the Competition Act 89 of 1998; the Promotion of Access to Information Act 2 of 2000.

¹⁹ The *Policy Document*, Introduction.

social role of enterprises and ensure compatibility and harmonisation with international standards.²⁰

In February 2007 a Draft Companies Bill was issued. The Department of Trade and Industry invited comments from academics and practitioners on the Bill. On 19 and 20 March 2007 they hosted a conference at Velmore Estate to discuss the Draft Bill. Amendments have been made to the Bill since then and the final Bill should be considered by Cabinet during May 2008. This version of the Bill will subsequently be submitted to the State Legal Advisors and should be introduced to Parliament by June 2008.

In this thesis I focus specifically on two of these objectives, namely the provision of a predictable and regulatory environment by considering a codification of directors' duties and the recognition of the broader social role of enterprises by considering in whose interests directors should manage a company. *King I* and *King II*, the *Policy Document* of the Department of Trade and Industry and the Companies Bill of 2007 are referred to. The viewpoints of the King Committees and the drafters of the *Policy Document* on the issue of stakeholder protection are discussed below.²¹ The codification of directors' duties is also discussed in more detail below,²² with specific focus on the partial codification in the Companies Bill of 2007.

²⁰ The *Policy Document* ch 1 par 2.

²¹ Clause 91(1)(b) of the Companies Bill of 2007 deals with stakeholder protection and are discussed in par 4.3 below.

²² Paragraph 5 below.

2 DIRECTORS' DUTIES

2.1 The Fiduciary Duty of Good Faith

A company is a legal entity that is separate from its management and shareholders. The company must act through individuals. The directors carry out managerial functions and responsibilities on behalf of the company.²³

Company directors are subject to various duties. These duties include statutory duties in terms of the Companies Act,²⁴ other legislation²⁵ and common law duties. Many of these duties have been confirmed in case law.²⁶

²³ Havenga "The Company, the Constitution and the Stakeholders" 134; Cilliers & Benade *Corporate Law* 5, 115–163; Beuthin & Luiz *Company Law* 179; Henochsberg *Commentary on the Companies Act* notes on s 214. See also Regulation 59 of Table A of the Companies Act in Schedule 1 that states: "the business of the company shall be managed by its directors".

²⁴ For example, ss 234–251 of the Companies Act. Sections 234–241 deal with conflict of interests of directors. Section 234 concerns the duty to disclose interests that a director may have in a contract. Section 235 concerns the manner and the time of such declaration, and s 236 deals with the written resolution that is required when a director has an interest in a contract. Section 237 deals with disclosures by interested directors and s 238 provides when the particulars of interest should be stated in a notice of a meeting. Section 239 provides for the minuting of such declarations of interests. Section 240 relates to the register of interests and s 241 concerns the duty of an auditor to register directors' interests in contracts. Sections 242–246 deal with proceedings at directors' meetings. Section 242 deals with the keeping of minutes at directors' and managers' meetings, and s 243 relates to the validity of proceedings of directors' meetings. Section 244 deals with effective resolutions at directors' meetings and s 245 with the attendance register. Section 246 sets out the duty of an auditor to satisfy himself that a minute book and attendance register are kept. Sections 247–251 are concerned with indemnity and relief from directors' liability and also deal with false statements by directors.

²⁵ For example, the Constitution; the Black Economic Empowerment Act; the Promotion of Access to Information Act; and the Labour Relations Act 66 of 1995 (hereafter the Labour Relations Act).

²⁶ Esser & Coetzee "Codification of Directors' Duties" 26. See, *inter alia*, *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd* 2005 (5) SA 550 (SCA) at 562 (the court refers to the situation where a director makes a profit through a breach of his fiduciary duties to the company – such a director will not be allowed to retain such a benefit); *Cyberscene Ltd v i-Kiosk Internet and Information (Pty) Ltd* 2000 (3) SA 806 (C) at 813–814 (a director stands in a fiduciary relationship to the company from the moment he begins to act as a director, even if he has not been formally appointed); *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T) at 64 (this case dealt with directors who formed a close corporation in competition with the company of which they were directors); *Du Plessis NO v Phelps* 1995 (4) SA 165 (C) at 170 (apart from their statutory duties, directors owe fiduciary duties to the company and common law duties to take reasonable care in the management of the company's affairs); *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163 (a director should observe utmost good faith towards the company and have an independent judgement when exercising his duties towards the company, he cannot be subject to the control of any nominator, principal or employer other than the company); *Shell Auto Care (Pty) Ltd v Laggar* 2005 (1) SA 162 (D) (concerning s 226 of the Companies Act which prohibits the making of a loan to directors in certain instances) in this case the plaintiff sought to recover certain loans made to the first defendant (Laggar), and two close corporations and a company of which Laggar was either the sole

Each company must have a director or directors.²⁷ A director's common law duties include his obligations as a fiduciary. The term "fiduciary" is applied to a large number of persons in diverse capacities, including commercial relationships. The relationship between a company and a director of that company is an example of a commercial fiduciary relationship.²⁸ A director can be seen as an agent, due to the fact that the director does not act on his or her own behalf, but on behalf of the company. A director can also be regarded as a trustee, since he does not own company assets, but controls them and exercises powers for the company's and not for his own benefit.²⁹ But the relationship between a director and a company remains unique. Categorising directors as agents or trustees is intended to prove the existence of a fiduciary duty rather than to equate directors with those particular positions.³⁰

A company directorship is generally regarded as one of the most complex fiduciary offices. Directors' fiduciary duties can be categorised into four headings, namely that (1) directors should prevent a conflict of interests, (2) not exceed the limitation of their power, (3) maintain an unfettered discretion and (4) exercise their powers for the purpose for which they were conferred.³¹

member or a member. Laggar the managing director of Shell issued a third-party notice claiming a contribution from his five fellow directors of one-sixth each of any amount that he was obliged to pay to Shell in terms of section 226(4) of the Companies Act. The important issue was whether a breach by any or all of the third parties of the provisions of section 226 entitled Laggar to claim an indemnification from the third parties, as contemplated in Uniform Rule 13 of the High Court. The court held that it did (see Havenga "Recent Cases" 137–138). See, generally, on directors' duties Pretorius et al. *Hahlo's Company Law* 278ff.

²⁷ A private company should have at least one director and a public company at least two: see s 208(2) of the Companies Act. See also clause 84 of the 2007 Companies Bill. The Bill distinguishes between not for profit, closely held and public interest companies (see clauses 8–10 for the definitions). A not for profit company should have at least three directors, a closely held company (which is not a public interest company) at least 1 and a public interest company at least four directors.

²⁸ Havenga "Breach of Directors' Fiduciary Duties" 366.

²⁹ *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* at 65C; Dawson "Acting in the Best Interest of the Company" 80; Beuthin & Luiz *Company Law* 192.

³⁰ Havenga "Breach of Directors' Fiduciary Duties" 366.

³¹ Cilliers & Benade *Corporate Law* 141. See ch 3 par 3.1 where directors' fiduciary duties are discussed as applied in terms of the English law. The cases referred to there are relevant when discussing directors' fiduciary duties in terms of South African company law because South African company law is based on English law.

All of these duties form part of one overriding duty, namely to act in good faith for the company as a whole.³² The interpretation thus far has been that the duties of directors should be exercised in the best interests of the company.

Similar to the position in Australia³³ and the United Kingdom,³⁴ a director has a legal duty to prevent conflicting interests between his own interests and those of the company. A director may obtain no other advantage from his position as director than that to which he is entitled to by way of his remuneration.³⁵ This rule applies even if the advantage was acquired openly, in good faith and not at the expense of the company. The important question is whether or not the advantage arose from the director's occupation of his office.³⁶ If a director enters into a contract with a third party that represents a conflicting interest between his own interests and that of the company the contract would be voidable.

If a director enters into a transaction on behalf of the company that goes beyond the capacity of the director, neither the company nor the third party can claim that the contract is void.³⁷ However, the director may incur liability within the company. The

³² Paragraph 2.1.1 below; Havenga *Fiduciary Duties of Company Directors* 25; *Percival v Wright* at 424; *Sibex Construction (SA) (Pty) Ltd v Injectaseal* at 65; *Novick v Comair Holdings Ltd* 1979 (2) SA 116 (W) at 130 and 151; *Swanee's Boerdery (Edms) Bpk (in Liquidation) v Trust Bank of Africa Ltd* 1986 (2) SA 850 (A) at 854. See also Du Plessis "Direkteure se Pligte Teenoor Partye Anders as die Maatskappy" 378; Havenga "Directors' Fiduciary Duties Under our Future Company-law Regime" 310–313.

³³ Chapter 4 par 3.2 above.

³⁴ Chapter 3 par 3.1 above.

³⁵ See *Robinson v Randfontein Estates Gold Mining Co* 1921 (AD) 168; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL) on conflict of interests, see ch 3 par 3.1 above on these cases. See also Pretorius et al. *Hahlo's Company Law* 305–309 for a discussion of these two cases. See further *Magnus Diamond Mining Syndicate v Macdonald & Hawthorne* 1909 ORC 65, where directors obtained information of diamondiferous land and purchased it in competition with their company. They were ordered to transfer the land back to the company and account for their profits. In *Industrial Development Consultants Ltd v Cooley* (1972) 1 WLR 443 the client of the company approached Cooley. The client did not want to conclude a contract with the company. Cooley was still ordered to account for its profits because the profits were made as a result of information that Cooley obtained in his capacity as managing director (see ch 3 par 3.1 above).

³⁶ Cilliers & Benade *Corporate Law* 142.

³⁷ Section 36 of the Companies Act of 1973.

company may suffer damages due to the contract that the director concluded and the director may be held liable for compensation.³⁸

A director must exercise the affairs of the company in an objective manner. He must not contract to act in a certain manner.³⁹ Directors should also exercise their powers for which they were conferred. A number of cases deal with the situation where directors used their powers to issue unissued shares with the purpose of ensuring continued control over the company instead of issuing shares with the purpose to acquire more capital.⁴⁰

2.1.1 The Traditional Position: Directors' Duties Owed to Whom?

The concept of “a company as a whole” relates to shareholders “collectively”, “all the shareholders, present and future”, and the company as a separate legal entity.⁴¹ Sealy refers to this concept of the company, where the company is an object of directors' duties, entirely perceived in terms of its members, as “corporate membership”.⁴²

Directors therefore do not owe fiduciary duties to shareholders as such. They must act in good faith in the interests of the company seen as the interests of the shareholders collectively.⁴³ Directors should treat all shareholders equally.⁴⁴

³⁸ Cilliers & Benade *Corporate Law* 144.

³⁹ See *Coronation Syndicate Ltd v Lilienfeld and New Fortuna Co Ltd* 1903 TS 489 where the directors contracted with a non-member to call a general meeting and to launch a proposal at the meeting for the increase in capital. If it is in the best interest of the company to contract to vote in a certain manner then the contract would be valid: *Fisheries Development Corporation of SA Ltd v Jorgensen*; *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163.

⁴⁰ *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Piercy v S Mills & Co Ltd* [1920] 1 Ch 77.

⁴¹ See ch 3 par 3.1.1 above where the concept was discussed in the context of United Kingdom company law. See further Du Plessis “Direkteure se Pligte Teenoor Partye Anders as die Maatskappy” 378; Havenga “The Company, the Constitution and the Stakeholders” 136; Sealy “Directors' Wider Responsibilities” 166; Havenga “Directors' Fiduciary Duties Under our Future Company-law Regime” 317; Larkin “The Fiduciary Duties of the Company Director (II)” E11–E17. This viewpoint was confirmed in the *Policy Document* ch 3 par 3.2.2. See also *September 2005 NEDLAC Report* pars 3.3.8 and 3.4.8 and generally *February 2005 NEDLAC Report* and the *Executive Summary of King II* par 17.

⁴² Sealy “Directors' Wider Responsibilities” 173.

⁴³ Farrar & Hannigan *Company Law* 381; Cilliers & Benade *Corporate Law* 139–140; Beuthin & Luiz *Company Law* 199; Henochsberg *Commentary on the Companies Act* notes on s 248; Blackman et al. *Commentary on the Companies Act* at 8–51.

The proper test to determine whether a director acted in the best interests of the company as a whole is to ask whether an intelligent and honest person in the same situation as the director would also have believed that the specific transaction was in the best interests of the company.⁴⁵

The traditional viewpoint is that directors do not stand in any fiduciary relationship with third parties. According to this view, a director has no general fiduciary duty to consider the interests of others. Obviously, directors are allowed to consider the interests of other groups and sometimes good management will require this, but ultimately the interests of these groups are subordinate to those of the company.⁴⁶ Fiduciary law does not exclude outside interests being taken into account, as long as the interests of the beneficiary are still served.⁴⁷

Pennington states the following on directors' duties: "These duties are owed exclusively to the company of which the defendant is a director. The fact that they are owed to the company does not impose parallel duties on a director towards the company's members or creditors."⁴⁸

If the traditional viewpoint that directors should act in the best interests of the company as a whole, namely the shareholders collectively is accepted, it has to be

⁴⁴ See Cilliers & Benade *Corporate Law* 149; Havenga "The Company, the Constitution and the Stakeholders" 136. See also *Galloway v Halle Concerts Society* (1915) 2 Ch 233; *Mutual Life Insurance Co of New York v Rank Organisation Ltd* 1985 BCLC 11. These cases remain relevant due to South African company law being based on United Kingdom company law. Shareholders do not have to act in the best interests of the company as a whole, they are not in a fiduciary relationship with the company: *Ben-Tovim v Ben-Tovim* 2001 (3) SA 1074 (C) at 1088.

⁴⁵ See Henochsberg *Commentary on the Companies Act* notes on s 248. This test is also applied in other jurisdictions. See, for example, Farrar & Hannigan *Company Law* 385; Davies *Gower and Davies' Principles of Modern Company Law* 371–372. See further ch 3 par 3.1.1 above.

⁴⁶ Fourie "Die Plig van Direkteure Teenoor Maatskappyskuldeisers" 25.

⁴⁷ This was also indicated during the United Kingdom company law review "Company Directors' Duties: "Directors' Wider Duties – Creditors" Chapter 5 available at www.aph.gov.au/senate/committee (accessed 20 May 2006). See also ch 3 where the United Kingdom company law is discussed in detail.

⁴⁸ Pennington *Company Law* 709. This comment, although made in respect of English law, remains relevant for South African law in view of our common law basis for company law.

considered whether and to what extent other groups should also be protected. Sealy states the issue crisply: “The issue is not necessarily whether these other groups should receive protection or not, but rather whether this can be achieved through the current company law structure as we know it.”⁴⁹ In this thesis the discussion of other interest groups is limited to those of individual shareholders, creditors, employees, consumers and suppliers, because these stakeholders are the most important in order to conduct any business successfully. Stakeholders are usually classified according to two main groups, namely internal, primary or contractual stakeholders and external, secondary or non-contractual stakeholders. This thesis focuses on the first group.⁵⁰

In chapter 2 a combined theory was proposed relating to the protection of the different stakeholders. This theory holds that directors should manage a company in the best interests of the company as a separate legal entity, and that the protection afforded different stakeholders varies during different stages of the life of a company. It was argued that legislation other than the Companies Act, should also play an important role in determining how and when a specific stakeholder should be protected.⁵¹ Various groups of stakeholders and the protection currently afforded to them are therefore discussed later in this chapter.

3 THE VARIOUS STAKEHOLDERS

3.1 Individual Shareholders

The common law fiduciary duties of directors are owed to the shareholders collectively, and not individually. It is impossible for a director to have a fiduciary duty towards the company and individual shareholders simultaneously, because the

⁴⁹ Sealy “Directors’ Wider Responsibilities” 173. Again, this comment was made with regard to English law, but it is equally applicable to South African law.

⁵⁰ Lubbe states that stakeholders of a company can be divided into traditional stakeholders, for instance, shareholders and lenders and emerging stakeholders like employees and consumers. See Lubbe “Die Toename in die Getal Belanghebbendes in Ondernemings” 60.

⁵¹ See ch 2 par 5.2 where a theory on the protection of stakeholders is proposed.

interests of shareholders and that of the company may be different. It will place a director in an untenable position if he has to observe fiduciary duties towards both.⁵²

Specific directors can have dealings with certain shareholders and then incur duties to that specific shareholder. These duties differ from the fiduciary duty a director has towards a company by virtue of his office as director. An example of the former duty is, for instance, when a shareholder authorises a director to sell his or her shares on the shareholder's behalf. If the director then comes across any relevant information concerning, for instance, the purchase price, the director is under a duty to disclose such information to the shareholder concerned.⁵³ Such a duty arises if a director places himself in one of the established legal relationships to which fiduciary duties are attached, as with agency discussed in the example mentioned above.⁵⁴

Directors have access to information regarding the company and that they are therefore clearly at an advantage when dealing with members' shares. The question arises whether a director can owe a fiduciary duty to an individual shareholder if an established legal relationship (such as agency) is not present. In *Percival v Wright*⁵⁵ the directors purchased shares from their members without revealing that negotiations were taking place regarding a takeover of the company. The shareholders had, however, approached the directors directly regarding the purchase of their shares,

⁵² Henochsberg *Commentary on the Companies Act* notes on s 214; Beuthin & Luiz *Company Law* 201; Cilliers & Benade *Corporate Law* 148. See also ch 3 par 3.1.2 where the position of individual shareholders is discussed as applied in terms of United Kingdom company law and ch 4 par 3.2.2 for the Australian position.

⁵³ See generally Beuthin "The Range of a Company's Interests" 155–176; Fourie "Vertrouwenspligte" 127–138. Some English decisions also confirm this, for example, *Briess v Woolley* [1954] AC 333 (HL); *Allen v Hyatt* (1914) 30 TLR 444 (PC) (it was stated that the fiduciary duties of the director arose by virtue of agency and not his directorship); *Peskin v Anderson* (2001) 1 BCLC 372 (CA) at 379 (the duties against the shareholders were based on a special factual relationship and not on directorship, events may take place that put directors in close and direct contact with the shareholders in a manner resulting in fiduciary duties, such as the duty to disclose certain information). See also Davies *Gower and Davies' Principles of Modern Company Law* 374. See ch 3 par 3.1.2 on these decisions.

⁵⁴ These established legal relationships can arise from agency (as discussed), representation or, special circumstances. These special circumstances include a duty of disclosure or a duty to give correct information. See Beuthin & Luiz *Company Law* 199; Henochsberg *Commentary on the Companies Act* notes on ss 214, 440A.

⁵⁵ [1902] 2 Ch 421. See generally Davies *Gower and Davies' Principles of Modern Company Law* 374–376.

rather than asking them to act as their agents. The court held that there was no fiduciary relationship between the directors and the shareholders individually.⁵⁶

In *Gething v Kilner*⁵⁷ the court in the Chancery Division stated that where a takeover bid has taken place, the directors of the offeree company owe a duty to their own shareholders, which includes a duty to be honest.

In *Coleman v Myers*⁵⁸ the New Zealand Court of Appeal stated that a fiduciary duty can arise even in the absence of a relationship of agency. The court qualified its statement, holding that this is only possible in the case of small and family companies, as shareholders often rely on directors for advice in this type of company. The facts were briefly as follows: the plaintiffs, who were minority shareholders in a small private company sold their shares to Myers, the managing director of the company. Myers then became the sole shareholder and liquidated certain of the company's surplus assets to declare a capital dividend, which was more than his acquisition costs. The plaintiffs then claimed that Myers had acquired their shares at an undervaluation.⁵⁹ The court held that there is no general principle that prevents directors from having fiduciary duties towards shareholders and that the managing director had a fiduciary duty towards the shareholders to protect their interests as well

⁵⁶ This judgment is not interpreted in such a broad manner by South African courts. Directors are not absolved from all responsibilities towards a buyer or seller of shares in their companies. See *Sage Holdings Ltd v The Unisec Group Ltd* 1982 (1) SA 337 (W) at 366; Fourie "Vertrouenspligte" 133–138; Cilliers & Benade *Corporate Law* 149. The decision of *Percival* was also widely criticised in England. See the *Cohen Report on Company Law Amendments* (1945) at pars 86–87 and the *Jenkins Report on Financial Reporting* (1995) at pars 89, 99(b). See also Farrar & Hannigan *Company Law* 380; Davies *Gower and Davies' Principles of Modern Company Law* 551; Rider "Percival" 471; Havenga *Fiduciary Duties of Company Directors* 25 at n 21.

⁵⁷ [1972] 1 WLR 337 at 341. Cilliers & Benade *Corporate Law* 149; Fourie "Vertrouenspligte" 133–134; *Pretorius v Natal South Sea Investment Trust Ltd* 1965 (3) SA 410 (W) at 418C (the directors of a company were obliged to provide material information to subscribers concerning the affairs of the company. It is therefore possible that South African courts will deviate from the *Percival* decision); Havenga *Fiduciary Duties of Company Directors* 28 n 22; *McLelland v Hullett* 1992 (1) SA 456 (D), discussed by Van der Merwe "Die Beskerming van Minderheidsaandeelhouders" 216, where it was considered whether shareholders had a cause of action against directors after the dissolution of a company. It was held that a shareholder does not have a right of action to enforce the maximization of his shareholder value.

⁵⁸ [1977] 2 NZLR 225 (SC). See Rider "Percival" 471–476; Fourie "Vertrouenspligte" 136 for a discussion of the judgment in *Coleman*.

⁵⁹ *Coleman v Myers*. See Sealy *Cases and Materials* 264 on this case.

as the interests of the company. The court did not, however, state that the *Percival* decision was wrongly decided on its particular facts. The decision of *Coleman v Myers* was approved in the decision of *Peskin v Anderson*.⁶⁰

At first glance it may seem as if these cases suggest that directors have fiduciary duties towards shareholders. However, their implication is explained in the following quotation from the Outer House in the case of *Dawson International plc v Coat Paton plc*.⁶¹ Lord Cullen stated the following:

If directors take it upon themselves to give advice to current shareholders, the cases cited to me show clearly that they have a duty to advise in good faith and not fraudulently, and not to mislead whether deliberately or carelessly . . . However, these cases do not, in my view, demonstrate a pre-existing fiduciary duty to the shareholders but a potential liability arising out of their words or actions which can be based on ordinary principles of law . . .

Thus, directors may find themselves liable to shareholders, individually, under ordinary principles of law, but this does not mean that they owe fiduciary duties to them directly.⁶²

3.2 Creditors

3.2.1 Introduction

It has been generally accepted in South African law that directors have no direct fiduciary duties towards creditors.⁶³ As stated above, any duty owed by directors was

⁶⁰ (2001) 1 BCLC 372 (CA). In *Peskin* it was held that fiduciary duties owed by directors to shareholders only arise if there is a special factual relationship between the directors and the shareholders in the specific case resulting in fiduciary obligations, such as a duty of disclosure of material facts or an obligation not to use confidential information. *Coleman* was also approved in *Platt v Platt* (1999) 2 BCLC 745 (CD). See ch 3 par 3.1.2 on the *Peskin* and *Platt* decisions.

⁶¹ (1988) SLT 854 at 861.

⁶² Farrar & Hannigan *Company Law* 380–383.

⁶³ Fourie “Die Plig van Direkteure Teenoor Maatskappyskuldeisers” 25; Havenga *Fiduciary Duties of Company Directors* 36; Cilliers & Benade *Corporate Law* 162–163. See Lombard “n Historiese Perspektief 1” 236 regarding the historical development of the interests of creditors through the different development stages of company law.

regarded as being to the company as a whole, because the company was regarded as a separate legal entity with its own rights and duties.⁶⁴

Case law, especially in other jurisdictions, started to show a trend to include the interests of creditors, among the interests that directors should consider when they manage a company, in certain circumstances.⁶⁵ South African case law has not yet ruled on this issue, but a number of commentators expressed their views on it.⁶⁶

This section considers whether directors, when they manage a company, should owe creditors a direct obligation to consider their interests, or whether an indirect obligation is sufficient. A direct obligation implies that creditors are direct beneficiaries of directors' duties. A direct obligation therefore changes the traditional viewpoint that directors manage the company in the best interests of the shareholders collectively. An indirect obligation entails that directors manage a company in the best interests of the company as a whole, that is, in the interests of the shareholders collectively. This does not mean that the interests of creditors are ignored as directors' consideration of creditors' interests would in any event usually be in the best interests of the company. It is argued below that directors should have an indirect duty towards creditors, but that the interests of creditors would receive priority in certain circumstances.⁶⁷

⁶⁴ *Aron Salomon v Salomon & Co Ltd* [1897] AC 22 (HL) at 22; *Dadoo v Krugersdorp Municipal Council* 1920 AD 530 at 550; *RP Crees (PVT) Ltd v Woodpecker Industries (PVT) Ltd* 1975 (2) SA 485 (R) at 489; *Lategan v Boyes* 1980 (4) SA 191 (T) at 200.

⁶⁵ See ch 4 par 3.2.3 for a discussion of case law in Australia and New Zealand and ch 3 par 3.1.3 for a discussion of English case law.

⁶⁶ See Lombard *Directors' Duties to Creditors* 1; Botha "Directors' Fiduciary Duties to Bondholders?" 287; Fourie "Die Plig van Direkteure Teenoor Maatskappyskuldeisers" 25; Du Plessis "Direkteure se Pligte Teenoor Partye Anders as die Maatskappy" 378; Locke "Fiduciary Duties Towards Creditors"; Luiz "Extending the Liability of Directors" 63; Havenga "Creditors, Directors and Personal Liability"; Cassim "Fraudulent or Reckless Trading" 328; Fourie "Dorklerk Investments" 328.

⁶⁷ The exact trigger as to when directors should consider the interests of creditors specifically is discussed below.

3.2.2 Arguments for and Against a Direct Duty Towards Creditors

As was stated above, directors do not currently have a direct duty to consider the interests of creditors in South African law. Du Plessis⁶⁸ states that the justification for this lies in the fact that creditors can protect themselves by way of a contract. There are a number of arguments for and against extending directors' fiduciary duties towards creditors. These arguments mainly relate to contractual protection, directors' conduct; traditional company law principles; sufficient and adequate remedies that are already available to creditors and concerns relating to the enforcement of the duty.⁶⁹

These arguments are discussed in detail below.

3.2.2.1 Contractual Protection

This argument relates to the fact that creditors can protect themselves by way of a contract.⁷⁰ They negotiate the terms and conditions of their contract with the company. It is, however, impossible to draft a contract that makes provision for every possible future event.⁷¹ It is also very expensive to draft a formal contract that covers for every possible contingency, making the costs of extending credit higher.⁷² A contract is only as good as the foresight of the parties and the advisors involved.

There are a number of contractual mechanisms that creditors can use to protect themselves.⁷³ These mechanisms have their own difficulties. Creditors can firstly make use of security. They are then given a privileged position if the debtor company becomes insolvent. Security is, however, not a viable option for all creditors. It is

⁶⁸ Du Plessis "Direkteure se Pligte Teenoor Partye Anders as die Maatskappy" 379.

⁶⁹ Lombard *Directors' Duties to Creditors* 5.

⁷⁰ Du Plessis "Direkteure se Pligte Teenoor Partye Anders as die Maatskappy" 388.

⁷¹ To explain this further: it is difficult for creditors to anticipate what a company might do. Creditors cannot, for example, foresee that a director may invest in a risky asset or lend to borrowers with poor credit ratings. See Keay "Directors' Duties to Creditors" 665–699.

⁷² Keay "Directors' Duties to Creditors" 691; Botha "Directors' Fiduciary Duties to Bondholders?" 289.

⁷³ Lombard *Directors' Duties to Creditors* 27–32.

especially time consuming to arrange for the granting and approval of security.⁷⁴ Smaller creditors also do not know how to monitor a security arrangement. Personal guarantees are another option, should the company not be able to repay the debt. Creditors, other than banks, are usually not in the position to demand such a guarantee. Creditors can also undertake a risk assessment of the company before extending the credit. The higher the risk, the higher the interest rate would be that they charge. The cost of such a risk assessment in many cases exceeds its benefits. Furthermore, many events that have a potential impact on risk cannot be foreseen by the creditors, for instance, a major change in the market industry. It can, however, be argued that creditors are adequately compensated for the risks they take by charging the company interest. The counter-argument is that the interest charged by the creditors is not always sufficient as risks can arise after the conclusion of the contract.⁷⁵

Some commentators suggest that contractual protection to creditors is feigned protection, because of the fact that creditors cannot assess the risks associated with the contract adequately.⁷⁶ It is, however, important to realise that creditors deal with a company as a matter of bargain, and not of trust, and bargain involves risk.⁷⁷

3.2.2.2 *Directors' Conduct*

This argument relates to the fact that directors' conduct might be influenced by the possible personal liability they could incur if they have a direct fiduciary duty towards creditors. Examples of such conduct include that they may be deterred from serving on boards,⁷⁸ or that they may become resistant to taking the necessary risks.⁷⁹

⁷⁴ Keay "Directors' Duties to Creditors" 687.

⁷⁵ Lombard *Directors' Duties to Creditors* 30. Creditors charge interest based on the risks they bear. Creditors usually assess their risks before they conclude a contract according to their expectations of the specific company and its financial position. Sometimes companies act outside of these expectations, but creditors will take unforeseeable events into account when calculating their risks. See also Wishart "Models and Theories" 335–336.

⁷⁶ Lombard *Directors' Duties to Creditors* 52; Wishart "Models and Theories" 335–336; Havenga *Fiduciary Duties of Company Directors* 34.

⁷⁷ Sealy "Directors' Wider Responsibilities" 176.

⁷⁸ This problem can be addressed by providing directors with adequate measures of relief; see the discussion below. See also Lombard *Directors' Duties to Creditors* 43–48.

The latter aspect can have a negative impact on company's wealth maximisation (and would thus not be to the benefit of the shareholders collectively). To explain this further, directors will rather protect their own positions than take risks and focus on what the shareholders want, namely profit maximisation. This is valid especially with regard to larger companies. In smaller companies directors are often also the shareholders. They will take more risks in order to save their company from financial distress. A way to overcome this problem of risk taking is to take out the necessary insurance. With such a safety net, directors might be more willing to continue to take necessary risks. The negative side of this is that directors might now take even higher risks, because they know they have the safety net of insurance.⁸⁰

3.2.2.3 *Traditional Company Law Principles*

This argument concerns the problem that an extension of director's duties would be contrary to company law principles. This is probably the strongest argument against fiduciary duties owed directly to creditors. The current company law model sees the company as a whole as the beneficiary of directors' direct fiduciary duties and will therefore be inadequate when directors consider wider interests than those of the shareholders collectively. If directors have to consider the interests of creditors, it would also not be appropriate only to regard the members as the group which can ratify and condone directors' actions. With the current model, only shareholders (and no other beneficiaries, such as creditors) have a say in the election and removal of the directors, and only the shareholders have voting rights.⁸¹

⁷⁹ Section 424 of the Companies Act, discussed in par (a) below, provides no defences that may be used by directors to escape personal liability. This can cause them to be more risk-averse. Section 248 of the Companies Act provides for a defence against personal liability, if the director acted reasonably and honestly. Section 248 is, however, only available when directors breach their common law duties and not for relief from statutory provisions, such as s 424. See further Lombard *Directors' Duties to Creditors* 69.

⁸⁰ Keay "Directors' Duties to Creditors" 685.

⁸¹ See s 208(2) of the Companies Act of 1973. The subscribers of the memorandum of a company are deemed to be the directors until the first directors are appointed. The articles usually provide that the directors be appointed by the general meeting. See Cilliers & Benade *Corporate Law* 119. See further s 220 of the Companies Act of 1973. This section enables a company to remove a director by way of an ordinary resolution of the general meeting before the expiration of his period of office. See Cilliers & Benade *Corporate Law* 126. See also *Swerdlow v Cohen* 1977 (1) SA 178 (W) at 182E–182G for the meaning of "ordinary resolution".

If one is of the view that directors should exercise their duties in the best interests of the company as a whole (in other words, with profit maximisation as their main goal), then direct fiduciary duties to creditors are problematic. Grantham maintains that “[a]n obligation on the board to act in the interests of non-shareholder groups, where the traditional notion of the company is retained, must entail an increase in the residual loss suffered by the shareholders”.⁸²

At present directors exercise their business judgment in ways that will promote the interests of the company. This will not always be possible if directors have direct fiduciary duties towards creditors too.⁸³ Then directors would have to consider the interests of creditors too and that may conflict with the interests of the company or the shareholders collectively.

3.2.2.4 Sufficient Remedies Available to Creditors

Some commentators argue that sufficient remedies are available to protect the interests of creditors and that an extension of directors’ duties is therefore not necessary. These remedies include statutory remedies in terms of which directors can be held personally liable for fraudulent, reckless, wrongful or insolvent trading as well as traditional insolvency law remedies. These remedies are discussed in more detail below.

a) Section 424 of the Companies Act

Section 424 of the Companies Act provides for personal liability of directors in certain circumstances. The section states that when it appears in a winding-up, judicial management or otherwise that any business of the company was carried out recklessly, or with the intention to defraud creditors of a company or any other person for any fraudulent purpose, the court may declare that any person, who was knowingly a party to the carrying-on of the business, is personally responsible, without any limitation of liabilities, for all or any of the debts or other liabilities of

⁸² Grantham “The Judicial Extension of Directors’ Duties to Creditors” 13.

⁸³ Grantham “The Judicial Extension of Directors’ Duties to Creditors” 12–13. See also the discussion of this problem where the position of employees is discussed in par 3.3 below.

the company. Proceedings in terms of section 424 can be instituted by way of motion or action.⁸⁴

Many commentators suggest that this remedy provides adequate protection for creditors and that an extension of directors' fiduciary duties is therefore not necessary.⁸⁵ Lombard⁸⁶ argues that this is not necessarily the case. She provides the following arguments: firstly, there are a number of uncertainties concerning the application of section 424. It is, for example, uncertain whether creditors' claims against the company should be quantified.⁸⁷ Secondly, section 424 provides for the protection of creditors against reckless trading by directors. "Reckless" has been interpreted either as acting "with gross negligence" or as "fraudulent[ly]".⁸⁸ It is clear that fault is required in both instances. This implies that directors, who acted in

⁸⁴ See generally Cilliers & Benade *Corporate Law* 160–162 on this section. Actions are normally commenced by way of a summons. It may lead, after pleadings, to a trial with oral evidence and cross-examination. Applications may be *ex parte* or on notice. An application need not be supported by an affidavit, but if a dispute arises regarding the facts, the court has a choice either to receive evidence orally or by way of an affidavit or order that the issues in dispute be tried by way of an action. See Ellis "Evidence" in *LAWSA* vol 3(2) par 73.

⁸⁵ This discussion only considers s 424 with regard to the question of whether s 424 provides adequate protection to creditors. See generally Cassim "Fraudulent or Reckless Trading" 162; Fourie "Dorklerk Investments" 328; Havenga "Director's Personal Liability" 719; Havenga "Creditors, Directors and Personal Liability" 65; Havenga "Directors' Fiduciary Duties Under our Future Company-law Regime" 321; Luiz "Extending the Liability of Directors" 788; Mackenzie "Directors' Liability" 370 for detailed discussions of s 424.

⁸⁶ Lombard *Directors' Duties to Creditors* 57–71.

⁸⁷ See *Dorklerk Investments (Pty) Limited v Bhyat* 1980 (1) SA 443 (W) at 448, where it is stated that the claim should be quantified; *Cronje NO v Stone* 1985 (3) SA 597 (T) at 604 where the court held that a specific amount need not be claimed. See also Lombard *Directors' Duties to Creditors* 58.

⁸⁸ See *Philotex (Pty) Ltd v Snyman; Braitex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) at 144; *S v Goertz* 1980 (1) SA 269 (C) at 272; *S v Parsons* (1980) 2 SA 397 (D) at 400 for "gross negligence". See *Anderson v Dickson NNO (Intermedia (Pty) Ltd Intervening)* 1985 (1) SA 93 (N) at 110 for "recklessly". In *Terblanche NO v Damji* 2003 (5) SA 489 (C) at 511 the court held: "The remedy created by section 424 is a punitive one and a director can attract liability for the debts of the company without proof of any causal connection between his sanctioned conduct and [those] debts." See Henochsberg *Commentary on the Companies Act* notes on s 424. See also the recent case of *Heneways Freight Services (Pty) Ltd v Grogor* 2007 (2) SA 561 (SCA) where the company instituted a claim against Grogor (the sole director of ITITC) to be held personally liable for ITITC's indebtedness to the appellant. The appellant claimed that Grogor acted fraudulently by providing creditors with cheques when Grogor knew or reasonably foresaw that there might not be sufficient funds in ITITC's bank account to honour the cheques. The court referred to s 424(1) of the Companies Act and states that "recklessness" includes gross negligence with or without consciousness risk taking. The mere fact that Grogor put the creditors at risk does not mean that he acted negligently. The court declined to hold Grogor personally liable.

breach of their fiduciary duties, but without fault, would not be held personally liable. However, Lombard mentions a number of arguments that indicate that section 424 provides protection to creditors.⁸⁹ The scope of section 424 is wider than that of directors' common law duties.⁹⁰ Section 424 does not only apply to an insolvent company or a company in financial distress, but also to a company that is financially sound.⁹¹ Directors who are in breach of their fiduciary duties are usually only liable for the amount of the benefit they took for themselves. This is not the case with section 424, because section 424 also contains a punitive element.⁹²

I submit that section 424 remains a powerful remedy in the hands of creditors.⁹³ However, the effectiveness of this remedy depends on the cost implications and whether or not the particular creditors' claim against the company is paid, if the claim is successful.⁹⁴ But, as was shown above, this remedy is not without shortcomings. They relate, *inter alia*, to the uncertainty of the application of section 424 and the fact that fault is required of directors who acted recklessly or fraudulently. Directors, who acted in breach of their fiduciary duties, but without fault, will therefore not be personally liable.⁹⁵ Despite these shortcomings in the section, an extension of

⁸⁹ Lombard *Directors' Duties to Creditors* 67–70.

⁹⁰ For example, s 424 is not limited to companies that are insolvent or in financial distress.

⁹¹ See *Body Corporate of Greenwood Scheme v 75/2 Sandown (Pty) Ltd* 1999 (3) SA 480 (W) at 487–488. See van der Linde “A Wake-up Call” 2–4 who discusses reckless trading and responsibility when approving financial statements in the context of close corporations. See *Harri NNO v On-Line Management CC* 2001 (4) SA 1097 (T), where the court referred to s 64(1) of the Close Corporations Act 69 of 1984 and said that the purpose of s 64(1) is to discourage members from mismanagement of a close corporation. In terms of this case, the corporation's liability is replaced with the joint and several liability of the corporation and those who conduct its business, thus eroding the protection of limited liability. This case was overturned in the case of *L&P Plant Hire BK v Bosch* 2002 (2) SA 662 (SCA). The court ruled that the purpose of s 64(1) was to provide creditors with a remedy. Section 64(1) could only be used if the corporation was unable to pay its own debts. The purpose of s 64(1) was therefore not to punish those who mismanage the corporation, but to protect creditors who suffered a financial loss. This was confirmed in the decision of *Saincic and Others v Industro-Clean (Pty) Ltd and Another* [2006] JOL 17559 (SCA). See also Havenga “Close Corporations Law 2002” 130–132 where she also discusses the *L&P Plant Hire BK v Bosch* decision.

⁹² Lombard *Directors' Duties to Creditors* 66.

⁹³ See also Fourie “Dorklerk Investments” 330; Havenga “Creditors, Directors and Personal Liability” 65.

⁹⁴ Havenga “Creditors, Directors and Personal Liability” 65.

⁹⁵ See the discussion above.

directors' duties to include a direct fiduciary duty to creditors is not proposed. The current company law regime, where shareholders are granted rights to remove and appoint directors, does not provide for such a direct fiduciary duty to creditors. Furthermore, if one provides creditors with direct protection other interests groups would also have to be considered. Employees, suppliers and consumers would arguably require the same protection.⁹⁶ I suggest that creditors can only be direct beneficiaries of directors' fiduciary duties if they do not receive adequate protection elsewhere. Despite its shortcomings, section 424 of the Companies Act is a powerful remedy in the hands of creditors and it cannot be stated that creditors are not adequately protected.⁹⁷

b) Insolvency Law Remedies

Commentators also suggest that creditors can rely on typical insolvency remedies to protect their interests. These remedies include statutory provisions or common law measures in terms of which transactions concluded by an insolvent company prior to winding-up can be set aside by the liquidator.⁹⁸ The statutory measures are contained in sections 26(1)(a) and (b), 29(1) and 30(1) of the Insolvency Act.⁹⁹ The common law action is the *actio Pauliana*.

The Insolvency Act provides for statutory grounds to avoid certain dispositions.¹⁰⁰ These remedies are only available after sequestration of the debtor's estate. The common law *actio Pauliana* is available before and after sequestration.¹⁰¹

⁹⁶ See the discussion below of other interest groups.

⁹⁷ See also ch 2 par 5.2 where a theory on the protection of stakeholders is proposed.

⁹⁸ Lombard *Directors' Duties to Creditors* 83–89.

⁹⁹ Act 24 of 1936.

¹⁰⁰ “Dispositions” is defined in s 2 of the Insolvency Act and means “[a]ny transfer or abandonment of rights of property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract therefore, but does not include a disposition in compliance with an order of the court”.

¹⁰¹ See Boraine “Towards Codifying the Actio Pauliana” 221–224; Lombard *Directors' Duties to Creditors* 83–89.

Section 26(1)(a) and (b) of the Insolvency Act concerns “dispositions not for value”. This refers to the disposition of assets by an insolvent company without receiving a fair consideration in turn. The liquidator may recover these assets in certain circumstances.¹⁰² Section 26 therefore deals with situations where dispositions by the debtor causes or increases his insolvency.

Section 29(1) of the Insolvency Act concerns “voidable preferences”. This relates to the situation where one creditor is preferred to another. A disposition by a debtor can be set aside as a voidable preference if it appears that the debtor, due to his financial position, was unable to pay all his creditors, but favoured a particular one. The transaction must have occurred no more than six months prior to liquidation and the liabilities of the company must immediately thereafter exceed its assets.¹⁰³

Section 30(1) of the Insolvency Act provides that where a debtor disposed of property at a time when the debtor’s liabilities already exceeded his assets, with the intention to favour one of his creditors over another and the debtor’s estate was subsequently sequestrated, the court may set aside the disposition.¹⁰⁴

In terms of the common law, a transaction can be set aside by way of the *actio Pauliana*.¹⁰⁵ The requirements to succeed with this remedy are as follows: the disposition must be of such a nature that the debtor’s assets are diminished by it, the

¹⁰² See s 26(1)(b) of the Insolvency Act. If the disposition occurred more than two years prior to the insolvent liquidation of the insolvent, the transaction may be set aside by the court if the liquidator can prove that the liabilities of the company exceeded its assets immediately after the disposition was made. If the disposition occurred within two years of the insolvent liquidation of the company, the onus is on the person benefited by the disposition to prove that, immediately after the disposition was made, the assets of the company exceeded its liabilities, in order to ensure that the transaction is not set aside by the court. On s 26 of the Insolvency Act, see generally, Hockly et al. *Insolvency Law* 129–131. See also *Rousseau NNO v Visser* 1989 (2) SA 289 (C) at 307; *Louw NO v DMA Fishing Enterprises (Pty) Ltd* 2002 (2) SA 163 (SE).

¹⁰³ See Boraine “Towards Codifying the Actio Pauliana” 223; Lombard *Directors’ Duties to Creditors* 84.

¹⁰⁴ See Boraine “Towards Codifying the Actio Pauliana” 223; Lombard *Directors’ Duties to Creditors* 84. See generally Hockly et al. *Insolvency Law* 134–136.

¹⁰⁵ Hockly et al. *Insolvency Law* 136–138.

recipient must not receive his own property, there should be an intention to defraud and the fraud¹⁰⁶ must have caused the loss suffered by the creditors.¹⁰⁷

It has been argued that these insolvency law remedies do not provide sufficient protection to creditors. The statutory measure relating to voidable preferences only covers preferences six months prior to liquidation. Section 30(1) relating to undue preferences may provide creditors with better protection, but the liquidator needs to prove that the liabilities of the insolvent exceeded the assets, which is not always an easy task. The liquidator also needs to prove the intention to prefer. In terms of one of the requirements of the *actio Pauliana*, the recipient should not receive his own property. This implies that the *actio Pauliana* cannot be applicable in preference situations. A number of general arguments against the use of these typical insolvency remedies can also be provided. First, they are only available once the company is in formal liquidation. Secondly, creditors have to rely on liquidators to institute actions on their behalf. They can only institute action themselves if the liquidator fails to do so and then they will have to indemnify the liquidator against possible costs of the proceedings.¹⁰⁸

3.2.2.5 Conclusions

Various arguments have been advanced against the recognition of a direct fiduciary duty to creditors. It was held that not all of the arguments have sufficient merit. The first argument relates to the fact that creditors can protect themselves by way of a contract.¹⁰⁹ It was held that some commentators suggest that contractual protection to creditors is feigned protection, because of the fact that creditors cannot adequately assess the risks associated with the contract. It was, however, argued that creditors deal with a company as a matter of bargain, and not of trust, and bargain involves

¹⁰⁶ The test is simply whether the object of the transaction was to give one creditor an unfair advantage over the others in insolvency. The normal criminal meaning of fraud is therefore not applicable in this case. See *Scharff's Trustee v Scharff* 1915 TPD 463 at 476 in this regard.

¹⁰⁷ As set out in *Hockey v Rixom* 1939 SR 107. See further Boraine "Towards Codifying the Actio Pauliana" 226–227; Lombard *Directors' Duties to Creditors* 84–85.

¹⁰⁸ See Lombard *Directors' Duties to Creditors* 87–89.

¹⁰⁹ Paragraph 3.2.2.1 above.

risk.¹¹⁰ Directors' conduct might be influenced by the possible personal liability they could incur if they have a direct fiduciary duty towards creditors and this would result in directors not taking the necessary risks. Directors can, however, obtain the necessary insurance and then take too high risks.¹¹¹ It was also indicated that sufficient remedies are available to protect the interests of creditors and that an extension of directors' duties is therefore not necessary.¹¹² It was then argued that statutory insolvency remedies do not provide sufficient protection to creditors and section 424 of the Companies Act, as a means to hold directors personally liable in certain circumstances, has its shortcomings.¹¹³

I submit that the argument concerning traditional company law principles has the most merit. First, if one is of the opinion that a company needs to be managed in the best interests of the company as a whole, then direct fiduciary duties to creditors can create difficulties. Second, if creditors are protected by such a direct duty, the question arises whether directors should also consider other interest groups.¹¹⁴ The main justification for creditors to receive protection to the exclusion of other groups' interests would be if creditors are not sufficiently protected by other means.¹¹⁵ Recognition of a fiduciary duty towards creditors is therefore necessary in certain instances.¹¹⁶ This is explored in more detail below. A theory on the protection of stakeholders was proposed in chapter 2.¹¹⁷ In terms of the proposed theory, directors should manage a company in the best interests of the company as a separate legal entity. A company is represented by several stakeholders such as shareholders, creditors and employees. These interests and the importance attached to them may differ at the various stages of a company's existence. It was argued that the protection

¹¹⁰ Paragraph 3.2.2.2 above.

¹¹¹ Paragraph 3.2.2.2 above.

¹¹² Paragraph 3.2.2.4 above.

¹¹³ Paragraphs (a) and (b) above.

¹¹⁴ Paragraph 3.2.2.3 above.

¹¹⁵ Paragraph 3.2.2.3 above.

¹¹⁶ Paragraph 3.2.2.3 above.

¹¹⁷ Chapter 2 par 5.2 above.

that these stakeholders receive in other legislation should play an important role to determine how much weight should be attached to the different interests.

3.2.3 A Fiduciary Duty to Creditors: Some Problems with the Construction of Such a Duty

Despite the general arguments against a duty to creditors, which were discussed above, certain jurisdictions started to rule in favour of such a duty. The rationale for the existence of a duty towards creditors was considered to be that if a company is in some form of financial difficulty, creditors should receive some form of special protection.¹¹⁸ A number of problems have, however, been highlighted in these rulings relating to the basis of the duty. South African courts have not yet ruled on this issue.¹¹⁹ The discussion below therefore focuses on case law in Australia, New Zealand and England, as discussed in chapters 3 and 4 above.¹²⁰

3.2.3.1 Beneficiary of the Duty

Courts were faced with the issue as to who should be beneficiaries when directors have a duty to protect the interests of creditors. To put this in other words, do directors have a direct or indirect duty to creditors? An indirect duty is in line with the traditional position that directors should manage a company in the best interests of the shareholders collectively. This indirect duty entails that directors would consider the interests of creditors if it is in the best interests of the company as a whole. The “company” therefore remains the beneficiary of directors’ fiduciary duties, but the “company” is redefined to include the interests of creditors in certain instances. Hence, directors could be liable for a breach of their fiduciary duties if they did not act in the best interests of the company, because they neglected to consider the interests of creditors. A direct duty indicates that directors have an independent duty to consider the interests of creditors.¹²¹

¹¹⁸ Keay “Interests of Company Creditors: When is it Triggered?” 335.

¹¹⁹ See, however, the Companies Bill of 2007 in which creditors are protected by the provision of specific remedies to protect their personal interests. This is discussed in par 4.3 below.

¹²⁰ See ch 4 par 3.2.3 for a detailed discussion of the case law of Australia and New Zealand and ch 3 par 3.1.3 for the English cases.

¹²¹ See Lombard *Directors’ Duties to Creditors* 114–115; Riley “Directors’ Duties and the Interests of Creditors” 91; Fourie “Die Plig van Direkteure Teenoor Maatskappyskuldeisers” 37

It seems as if the Australian cases favour an indirect duty. In *Walker v Wimborne*¹²² an indirect duty to creditors was favoured. It was also stated in *Spies v The Queen*¹²³ that directors' duties are not owed to creditors directly. In contrast, in *Jeffree v National Companies & Securities Commission*¹²⁴ it was held that directors have a direct duty to creditors. This decision was, however, based on the English case of *Winkworth v Edward Baron Development Co Ltd*¹²⁵ and it has been argued that this decision is not compelling evidence for a direct duty to creditors. His Lordship only made the remarks relating to directors' duties to creditors *obiter*.

Most cases suggest that this duty to creditors arises at near insolvency. In the *Walker* decision insolvency was not expressly referred to as a requirement to establish a duty to creditors, but the company was insolvent. In *Horsley & Weight Limited*¹²⁶ the court held that a company should be insolvent or near insolvency in order for directors to consider the interests of creditors. In *Ring v Sutton*¹²⁷ the court held that directors have an indirect duty to consider the interests of creditors, even if the company is solvent. The cases are therefore confusing as to when and precisely at what point directors should consider the interests of creditors. Keay suggests an objective test, stating that the best trigger would be that the circumstances of a specific company indicate that a director could reasonably be able to expect that his or her actions could lead to insolvency of the company.¹²⁸

¹²² (1976) 137 CLR 1 (HC) at 449. See also *Ring v Sutton* (1980) 5 ACLR 546 at 550 where the *Walker* decision was cited with approval. See ch 4 par 3.2.3 above, where these cases are discussed.

¹²³ (2000) 201 CLR 603 (HC) at 635. See ch 4 par 3.2.3 above

¹²⁴ (1989) 15 ACLC 217 at 228. See ch 4 par 3.2.3 above

¹²⁵ [1987] 1 All ER 114 (HL). See ch 3 par 3.1.3 above.

¹²⁶ [1982] 1 Ch 442 (CA) at 451. See ch 3 par 3.1.3 above.

¹²⁷ (1980) 5 ACLR 546 at 547. See ch 4 par 3.2.3 above.

¹²⁸ The *Re Horsley & Weight Ltd* [1982] 1 Ch 442 (CA) decision also worked with an objective test at 454–456. The question is asked whether at the time of the payment in question the directors “should have appreciated or ‘ought to have known’ that it is likely to cause loss to creditors or threatened the continued existence of the company”.

3.2.3.2 *When Does the Duty to Creditors Arise?*

Case law reflects different opinions on the question of when a duty to creditors arises. It has been decided that the duty should arise at insolvency of a company¹²⁹ or that it should be a continuous duty¹³⁰ that directors owe creditors. Other cases suggest that this duty only arises in cases of near insolvency.¹³¹ Most cases assume that the company should be in some form of financial difficulty before directors' fiduciary duties include a consideration of the interests of creditors.¹³² The reason for a duty to creditors when a company is insolvent or in circumstances of near insolvency lies in the fact that the creditors' funds are at risk, and not the funds of the shareholders.¹³³

The *Walker* case was one of the first decisions to give consideration to the interests of creditors. In this decision, the court did not state expressly that insolvency was a condition to establish a duty to creditors. The company in question was, however, insolvent. In *Ring v Sutton*¹³⁴ the court held that directors had a fiduciary duty to creditors, although the company was solvent. In *Horsley & Weight Limited*¹³⁵ the court held that the company should be insolvent or nearly so in order for directors to have fiduciary duties to the creditors. In the *Nicholson*¹³⁶ case the court also stated that insolvency was a requirement in order for directors to have fiduciary duties towards creditors. However, the court went further and stated that creditors can have

¹²⁹ See *West Mercia Safetywear Ltd (in liq) v Dodd* at 252 and *Kinsela v Russell Kinsela (Pty) Ltd (in liq)* at 401. In *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) at 254 it was stated that: "If a company is insolvent in the sense of its assets exceeding liabilities there can, I think, be no question of a separate duty to creditors". See Fourie "Die Plig van Direkteure Teenoor Maatskappyskuldeisers" 38–40; Barrett "Directors Duties to Creditors" 229; Keay "The Duty to Creditors" 382. See ch 4 par 3.2.3 above.

¹³⁰ *Winkworth v Edward Barron Development Co Ltd* at 118.

¹³¹ In *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA).

¹³² See, however, the *Ring v Sutton* decision discussed above. In this decision the court of Appeal of New Zealand held that directors should consider the interests of creditors, although the company in question was clearly solvent.

¹³³ Keay "Directors' Duties to Creditors" at 668 where he states that "[t]he interests of the company are in reality the interests of the creditors alone".

¹³⁴ (1980) 5 ACLR 546 at 547.

¹³⁵ [1982] 1 Ch 442 (CA) at 451.

¹³⁶ [1985] 1 NZLR 242 (CA) at 249.

an action against directors for a breach of a particular duty of care, but based on “the ordinary negligence principles”.¹³⁷

These cases provide quite confusing rulings as to when directors should consider the interest of creditors. If one accepts that directors have an indirect duty towards creditors (as discussed above), but that creditors should receive priority in certain instances, then one needs to know exactly when this duty should arise. Having a vague obligation imposed on directors to consider the interests of creditors in certain circumstances is not helpful.¹³⁸

The general opinion of the courts is that directors have an indirect duty to consider the interests of creditors that arises in cases of insolvency or near insolvency. It is, however, unclear whether insolvency relates to the fact that the company’s liabilities exceed its assets or whether it relates to the fact that the company is unable to pay its debts as they become due and payable.¹³⁹ It has been argued that it is not ideal to link directors’ duties to creditors to the financial position of the company. Fourie and Sealy¹⁴⁰ suggest that insolvency as a trigger for a duty to creditors is not the answer. Insolvency is regarded as too vague a concept. Sealy suggests the following:

It would be absurd, in any case, to allow a body of rules to develop which allowed directors to do X when the company has divisible profits, Y when there were profits which were not divisible, Z when there were profits but the funds at risk were nationally the shareholders’ capital contributions, and something else again when what they were hazarding was ‘creditors’ money’.¹⁴¹

¹³⁷ At 250. As stated above, these comments lead to concern that a direct duty to creditors was implied. See also ch 4 par 3.2.3 on these Australian cases.

¹³⁸ Keay “Directors’ Duties to Creditors” 671.

¹³⁹ Riley “Directors’ Duties and the Interests of Creditors” 89.

¹⁴⁰ Fourie “Die Plig van Direkteure Teenoor Maatskappyskuldeisers” 37; Sealy “Directors’ Wider Responsibilities” 178–180. See also Grantham “The Judicial Extension of Directors’ Duties to Creditors” 15; Keay “Interests of Company Creditors: When is it Triggered?” 320.

¹⁴¹ See Sealy “Directors’ Duties” 178. See also Grantham “The Judicial Extension of Directors’ Duties to Creditors” 15

Keay¹⁴² refers to the various possibilities when a duty to creditors should arise, namely insolvency, near insolvency, doubtful solvency and the risk of insolvency. All of these possibilities concern a company being in financial difficulty. It was indicated above that it is difficult to have insolvency as a requirement, because it is unclear what is meant by insolvency.¹⁴³ A further problem with the requirement of insolvency is whether or not it should apply strictly or only when the directors knew that the company was insolvent. It is very difficult to prove knowledge. It might be better to introduce an objective element (e.g., by requiring the director to have known that the company was insolvent). Near insolvency¹⁴⁴ also creates problems as a requirement. It is very difficult in most situations to say from what point on a company is nearing insolvency. Doubtful solvency has no definition in legislation. It is a broader concept than insolvency. The question also arises who must doubt the solvency. The last option concerns the risk of insolvency. The duty to creditors arises when there is a risk of insolvency. To require knowledge when there is a risk of insolvency is also problematic. A director who has not sought to apprise himself of the state of affairs of the company will be at an advantage since he will have no knowledge of the insolvency.

Owing to these problems Keay¹⁴⁵ suggests an objective test to determine when directors should consider the interests of creditors.¹⁴⁶ I agree with his proposal of an objective test:¹⁴⁷ “It is suggested that the most appropriate trigger would be where the

¹⁴² Keay “Interests of Company Creditors: When is it Triggered?” 315.

¹⁴³ See *Kinsela v Russell Kinsela (Pty) Ltd (in liq)* at 401; *West Mercia Safetywear Ltd (in liq) v Dodd* at 252; *Nicholson v Permakraft (NZ) Ltd* at 254.

¹⁴⁴ As required in *Nicholson v Permakraft (NZ) Ltd*.

¹⁴⁵ Keay “Interests of Company Creditors: When is it Triggered?” 320.

¹⁴⁶ A number of factors should be considered when determining when such a duty arises. These factors include the need for risk taking (the more obvious it is that creditors’ interests are at risk the lower the risk must be to which directors expose the company); an increase in costs (a duty towards creditors will increase the company’s cost, as directors would have to undertake investigations to ascertain whether their contemplated actions could precipitate insolvency) and the need for certainty (the law must allow directors to manage a company as they deem fit, but the law should not allow directors to ignore the interests of creditors. A balance is thus needed). See Keay “Interests of Company Creditors: When is it Triggered?” 320–328.

¹⁴⁷ The *Horsley & Weight Ltd* decision also worked with an objective test at 454–456. The question is asked as to whether at the time of the payment in question the directors “should have appreciated or

circumstances of a company are such that its directors know, or can reasonably expect, that the action upon which they are going to embark could lead to insolvency of the company.”¹⁴⁸ The moment when directors’ fiduciary duties to creditors are triggered would therefore not be the same in all cases. In determining whether or not directors complied with their fiduciary duties, the court would have to take the specific circumstances of each company into account. In the *Nicholson* decision the court held that courts can inquire into the state of a company’s affairs.¹⁴⁹ The court should take all relevant factors at the time of the director’s decision into account. Wishart¹⁵⁰ argues that judges do not necessarily have the expertise to determine whether a director made an acceptable business decision. However, in the decision of *Kinsela*¹⁵¹ it was accepted that although courts have traditionally been cautious to interfere in the decisions of directors, the *Nicholson* decision indicated that an examination of the decisions made by a board is necessary in some cases.¹⁵²

3.2.3.3 Conclusions

In this section the protection awarded to creditors was examined. Arguments were raised for and against a direct duty to creditors.¹⁵³ The majority of cases indicated that this duty to creditors should be an indirect duty.¹⁵⁴ Owing to some shortcomings in the protection currently afforded creditors, mainly the problems associated with section 424 and contractual protection, it is submitted that directors should consider the interests of creditors in certain instances. The interests of creditors would therefore sometimes receive priority. The rationale for this lies in the fact that the company is effectively trading with the creditors’ money when it is in financial

‘ought to have known’ that it is likely to cause loss to creditors or threatened the continued existence of the company”.

¹⁴⁸ At 328.

¹⁴⁹ At 250.

¹⁵⁰ Wishart “Models and Theories” 341.

¹⁵¹ At 402.

¹⁵² Keay “Interests of Company Creditors: When is it Triggered?” 328.

¹⁵³ Paragraph 3.2.2 above.

¹⁵⁴ Paragraph 3.2.3.1 above.

distress. The decided cases do not provide clear guidelines as to when such a duty would arise. Keay suggests an objective test, stating that the best trigger would be that the circumstances of a specific company indicate that a director could reasonably be able to expect that his or her actions could lead to insolvency of the company.¹⁵⁵ I agree that this is the best option to determine when directors should consider the interests of creditors. I therefore submit that directors should consider the interests of creditors in certain instances, even if this consideration can be to the detriment of the shareholders. These instances include when a company is in financial difficulty, as discussed above. This suggestion is in line with the theory proposed in chapter 2 stating that different stakeholders should be recognised at different stages in the life of a company. Stakeholders should especially be protected if they do not receive adequate protection in legislation.¹⁵⁶ Creditors are an example of such stakeholders.

3.3 Employees

3.3.1 Introduction

The traditional view is that directors should exercise their fiduciary duties in the best interests of the company as a whole. As discussed in paragraph 3.2.3.3, when a company is in financial distress directors may give the interests of creditors preference over those of the shareholders.

Employees are not protected in terms of the current Companies Act. The position in South Africa would arguably be similar to the common law position in England when it comes to the interests of employees. The legal justification for gifts or any other benefit that directors may allow employees to acquire is the ultimate benefit of the company as a whole.¹⁵⁷ For instance, directors can provide employees with pension benefits if the object is to attract loyal employees, because it will be to the benefit of

¹⁵⁵ Paragraph 3.2.3.2 above.

¹⁵⁶ Chapter 2 par 5.2 above.

¹⁵⁷ See ch 3 par 3.1.4 above on the *Hutton v West Cork Railway Co* (1883) 23 ChD 654 (CA); *Parke v Daily News Ltd* [1962] Ch 927 cases.

the shareholders.¹⁵⁸ Employees' interests should, however, be considered by directors in certain instances. Possible methods of protecting employees are discussed below.

3.3.2 Possible Methods of Protecting the Interests of Employees

3.3.2.1 Worker Participation

It has been suggested that worker participation on company boards may promote their interests.¹⁵⁹ Worker participation can take various forms, for example,

- co-ownership by the employees by concluding an agreement with them that they will receive more than half of the issued share capital within a certain period of time;
- separation of power by way of works councils; and
- appointment of directors who are also employees.¹⁶⁰

The two main organs of the modern company in South Africa are the general meeting of shareholders and the board of directors.¹⁶¹ The board of directors is usually involved in the day-to-day management of the company.¹⁶² The board has powers to bind the company, but these powers are not unlimited.¹⁶³ General meetings are

¹⁵⁸ Beuthin "The Range of a Company's Interests" 167–168.

¹⁵⁹ Du Plessis "Werkersdeelnamen" 380–395.

¹⁶⁰ Delport "Werkplekforums" 414.

¹⁶¹ The managing director, often referred to as the Chief Executive Officer (CEO), sits on the board of directors. Cilliers & Benade *Corporate Law* 92, 116; Beuthin "The Range of a Company's Interests" 155. See also Havenga "Corporate Opportunities" 40–41; Delport "Werkplekforums" 410–411; Du Plessis "Werkersdeelnamen" 383.

¹⁶² It is a typical feature that the board is involved in the management of a company, in other words, the day-to-day affairs of the company, in terms of the traditional unitary board structure. But South African boards do not make use of the traditional unitary board structure. The board plays more of a supervisory role, especially due to the presence of non-executive directors and the managers who conduct the day-to-day affairs of the company. See par (a) below. See also Delport "Werkplekforums" 410; Du Plessis "Werkersdeelnamen" 383–385; Beuthin "The Range of a Company's Interests" 155.

¹⁶³ The constitution of the company usually provides which issues should be considered by the general meeting and which by the board of directors. See ss 180–198 in the Companies Act on general meetings and ss 242–246 in the Companies Act on board meetings.

usually convened by the board of directors.¹⁶⁴ They should convene such a meeting if it is in the best interest of the company as a whole.¹⁶⁵

The board of directors perform certain acts of management and agency.¹⁶⁶ The directors are appointed by the members at an annual general meeting.¹⁶⁷ The general meeting may also remove directors from office by way of a general resolution.¹⁶⁸ The board of directors acts with the general meeting concerning internal matters, but there is a clear separation of powers.¹⁶⁹ If certain matters are assigned to the board of directors in terms of the articles of association, then only the board has the power to deal with those matters. The general meeting may, however, intervene with the powers of the board in certain matters. These matters include situations where the board of directors refuses or is unable to institute action on behalf of the company;¹⁷⁰ when the board of directors cannot or will not exercise powers reserved for it; or when certain powers have been reserved for the board of directors, but the particular

¹⁶⁴ The Registrar may also call a meeting where the directors of a company became incapacitated or have ceased to be directors (see s 182). The court may also call a meeting on its own initiative or on application by the Registrar (see s 183).

¹⁶⁵ Cilliers & Benade *Corporate Law* 95; Blackman et al. *Commentary on the Companies Act* at 7–17; Havenga *Fiduciary Duties of Company Directors* 1.

¹⁶⁶ See Cilliers & Benade *Corporate Law* 116; Beuthin “The Range of a Company’s Interests” 156; Beuthin & Luiz *Company Law* 199; Blackman et al. *Commentary on the Companies Act* at 8-07-8-11.

¹⁶⁷ The annual general meeting is a general meeting subject to a number of provisions stipulated in the Companies Act. A company should have an annual general meeting within 18 months after the company’s incorporation and subsequent annual general meetings are to be held every 9 months after the end of each ensuing accounting date, but still within 15 months of the date of the previous meeting (see s 179 (1) of the Companies Act). The annual general meeting should deal with the matters as stipulated in the Companies Act and in the articles of association of the company (s 179(2) of the Companies Act). These matters typically include the sanctioning of a dividend, the consideration of the financial statements, the election of directors and the appointment of an auditor See ss 185(6) (resolutions to which members have notice by requisition), 221(3) (extension of general authority to directors to issue shares), 226(3)(b) (approval of certain loans to directors), 286 (annual financial statements to be considered). See Cilliers & Benade *Corporate Law* 93; Henochsberg *Commentary on the Companies Act* for notes on these sections. See also Wixley & Everingham *Corporate Governance* 24.

¹⁶⁸ Section 220 of the Companies Act. The shareholders can also amend the articles of association by way of a special resolution, s 62 of the Companies Act.

¹⁶⁹ Cilliers & Benade *Corporate Law* 116. See Du Plessis “Die Algemene Vergadering en die Direksie” 267 where the status of the general meeting and the board of directors is discussed.

¹⁷⁰ See Naudé *Die Regsposisie van die Maatskappydirekteur* 92; Davies Gower and Davies’ *Principles of Modern Company Law* 187.

act is voidable because the board has exceeded or abused its powers.¹⁷¹ The board of directors also acts on behalf of the company in transactions with third parties, but the directors do not have unlimited powers to bind the company.¹⁷²

Employees do not participate in company boards of South African companies. Neither do they have any role in the appointment or removal of directors.¹⁷³ This decision lies with the general meeting.¹⁷⁴ Clause 88 of the Draft Companies Bill of 2007 also states that directors of a company are elected by the holders of shares entitled to vote at such election.¹⁷⁵ In terms of clause 88(4) the terms of directors of a widely held company¹⁷⁶ must be arranged so that as nearly as is possible, the terms of one third of the directors expire each year. A company's memorandum of incorporation may, however, state otherwise. A director may be removed by way of a

¹⁷¹ See generally Cilliers & Benade *Corporate Law* 88. See also *LSA UK Ltd (formerly Curtains Ltd) v Impala Platinum Holdings Ltd* (2000) SCA case number 222/98 available at <http://www.uovs.ac.za/apps/law/appeal/files/2000/1/253Lsa.doc> (accessed 30 July 2007); *Ben-Tovim v Ben-Tovim* 2001 (3) SA 1074 (C) at 1085I–1086D (if the board does not want to or cannot exercise the powers vested in them, then the general meeting may do so). The powers conferred on a specific organ by the articles of association of a company are the exclusive powers of that organ (see *John Shaw and Sons (Salford) Ltd v Shaw* (1935) 2 KB 113 (CA)). The general meeting may not simply usurp the powers of the board (see *Automatic Self-Cleansing Filter Syndicate v Cunninghame* (1906) 2 Ch 34 (CA)).

¹⁷² Delport “Werkplekforums” 410.

¹⁷³ Du Plessis “Werkersdeelname” 384, 393; O'Regan “Possibilities for Worker Participation” 113–132.

¹⁷⁴ See s 208(2) on the appointment of directors and s 220 of the Companies Act on the removal of directors. See n 70 above where s 220 is briefly discussed.

¹⁷⁵ This is subject to clause 90(3), which provides that if a vacancy arises in the board, the remaining members of the board may appoint a person to fill the vacancy and serve until the time that the vacating director's term would otherwise have ended.

¹⁷⁶ See clause 8 of the Draft Companies Bill of 2007 regarding the definition of a widely held company. It is defined as:

- (1) For the purposes of this Act, every for profit company is either a widely held company, or a closely held company.
- (2) A for profit company is a widely held company if –
 - (a) the company's Memorandum of Incorporation –
 - (i) permits it to offer any of its shares to the public, within the meaning of sections 60 and 61;
 - (ii) limits, negates or restricts the pre-emptive right of every shareholder set out in section 36 (1); or
 - (iii) provides for the unrestricted transferability of any of its shares; or
 - (b) a majority of its shares are held by another widely held company, or collectively by two or more related or inter-related persons, any one of which is a widely held company.

special resolution at a meeting of holders of the shares entitled to vote in terms of the Companies Bill.¹⁷⁷

In England, directors also do not participate on boards, but¹⁷⁸ section 309 of the (now repealed) Companies Act of 1985 stated that directors of a company are to have regard to the interests of employees of the company in the performance of their functions.¹⁷⁹ This duty was still owed to the company and not to the employees individually. It did not create any enforceable rights for employees.¹⁸⁰ The full impact of this section was not clear. Before the enactment of this section, directors were entitled to consider the interests of employees, if it was in the best interest of the company as a whole. Section 309 went somewhat further and required directors to take the interests of employees into account. It did not, however, state whose interests would receive priority in the case of a conflict between the interests of employees and those of the company. The section did not change the meaning of “the company as a whole”, which would still be paramount.¹⁸¹ It was seen in chapter 3 that the Companies Act of 2006 now lists factors that directors should keep in mind when managing a company. But employees do not have any remedies to enforce their rights.¹⁸² It was therefore argued that section 172(1) does not provide employees with more protection than the previous section 309.

¹⁷⁷ See clause 88.

¹⁷⁸ Du Plessis “Direkteure se Pligte Teenoor Partye Anders as die Maatskappy” 386–387. The position in England is discussed in detail in ch 3. See ch 3 par 4.3 on the 2006 United Kingdom Companies Act and specifically s 172(1).

¹⁷⁹ See also Section 719 of the Companies Act of 1985 where it was stated that the powers of the company shall be deemed to include a power to make provision for the benefit of persons employed or formerly employed by the company. It seems that this power may be exercised even if it is not in the best interest of the company.

¹⁸⁰ See ch 3 par 3.1.4 above. See further O’Regan “Possibilities for Worker Participation” 120.

¹⁸¹ Birds et al. *Boyle & Birds’ Company Law* 503.

¹⁸² See ch 3 par 4.3 for comments on this section. This section lists various stakeholders, but stakeholders will not be able to enforce their “rights” against directors.

South Africa currently applies the unitary board structure.¹⁸³ In Germany, where a two-tier board structure applies, employees have board representation through the system of co-determination.¹⁸⁴ The structure of a company board may be relevant to the effectiveness of worker participation on board level. In order to decide which board structure is best suited for South Africa, it is necessary to consider its counterpart, the two-tier board structure. It was stated above that the unitary board structure in South Africa consists of a board of directors and managing directors. The board monitors, oversees and guides the managing directors, who conduct the day-to-day affairs of the company. It is usually required of the board of directors to comprise of non-executive and independent directors.¹⁸⁵ The different versions of the unitary board are discussed below.¹⁸⁶

The two-tier board structure operates on two levels, namely the supervisory board and the management board. The supervisory board oversees the activities of the management board and the management board conducts the day-to-day affairs of the company.¹⁸⁷

It is, however, not always that easy to distinguish between these two structures due to their similarities. For example, in a large public company with a unitary board structure, the board of directors has similar functions compared to the supervisory board in a company with a two-tier board structure. It is stated below that the supervisory board is independent and oversees the work done by the management board in a two-tier board structure. The board of directors in a unitary board structure is also independent, especially if the board consists of a balance of non-executive and executive directors, and oversees the work done by the managers.

¹⁸³ See, however, n 162 above.

¹⁸⁴ See, generally, Hopt “The Two-Tier Board” available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=159555#PaperDownload (accessed 8 May 2008).

¹⁸⁵ See par (e) below for explanations of these terms.

¹⁸⁶ See par (a) below.

¹⁸⁷ This is discussed in detail in par (b) below.

a) The Unitary Board Structure as Applied in South Africa

South African companies have a unitary board structure (one-tier structure), but the board structure applicable in South Africa differs from the traditional unitary board structure.¹⁸⁸ In the typical traditional unitary board structure the functions of the board of directors and that of the managers overlap. The chairperson is also one of the managers and therefore supervises himself.

The *Cadbury Report* released in the United Kingdom¹⁸⁹ in 1992 highlighted that the traditional unitary board structure was adapted: the chairperson would still be part of the people who conduct the day-to-day affairs of the company, but it was recommended that the board of the company also have non-executive directors and not just executive directors. *King II* and the United Kingdom *Combined Code of 2006* recommended a board structure where¹⁹⁰ the board of directors (comprising both executive and non-executive directors) oversees and monitors the managers who conduct the day-to-day business of the company. This board structure is currently applicable in South Africa.

b) The Two-Tier Board Structure as Applied in Germany

German company law traditionally uses the two-tier board system which strictly separates the management and supervisory functions.¹⁹¹ The two-tier board structure

¹⁸⁸ The *Policy Document* ch 4 par 4.4.2, *February 2005 NEDLAC Report* annexure 2 par 4.4.2. See Havenga et al. *Commercial Law* 333; Cilliers & Benade *Corporate Law* 85 concerning the organs of a company.

¹⁸⁹ This report is discussed in detail in ch 3 par 4.1 above.

¹⁹⁰ This code is discussed in ch 3 par 4.1 above.

¹⁹¹ This was introduced into German law in 1861 with the *General German Commercial Code* (this code applies to all merchants, all companies are regarded as merchants notwithstanding the nature of their activities). See Du Plessis “Corporate Governance Reflections on the German System” 22; Havenga *Fiduciary Duties of Company Directors* 229. See generally on corporate governance issues in Germany Du Plessis et al. *German Corporate Governance*. On 8 October 2001 the European Council Regulation for the establishment of the European company (SE) was adopted. This Regulation was accompanied by another Regulation on co-determination by employees. The Regulation on the SE became law in October 2004. The member states of the EU can now choose between a two-tier and a unitary board structure. This is also confirmed in the *Corporate Governance Code for Listed German Corporations* (discussed in par (c) below). See, generally, on the SE Hannigan *Company Law* 57–59; Du Plessis et al. *German Corporate Governance* 159–161 (The SE was originally proposed by the European Commission in 1970. It took a long time before it was implemented mainly due to issues like the interface between European and national law.)

is rather complex. This is particularly so in respect of its element of employee participation.

All German publicly traded companies (*Aktiengesellschaften*) are incorporated under the Stock Corporation Act of 1965 (*Aktiengesetz*).¹⁹² The public company has three organs,¹⁹³ a supervisory board (*Aufsichtsrat*) consisting of employees and shareholders (usually on a 50:50 ratio), a management board (*Vorstand*) which conducts the day-to-day management of the company and a general meeting (*Hauptversammlung*). In a private company (*Gesellschaft mit beschränkter Haftung* (*GmbH*)), only two organs are required, namely a management organ (similar to the management board in public companies) and the organ for the incorporators (similar to the general meeting in the public company). The element of co-determination is compulsory in larger private companies. In the discussion that follows, the focus is on public companies, since the relationship between the different organs is best illustrated in this type of company.¹⁹⁴

Members and shareholders enforce their rights through voting at the general meeting.¹⁹⁵ The general meeting may only decide on matters concerning management when requested by the management board.¹⁹⁶ The general meeting also appoints the members of the supervisory board.¹⁹⁷ The general meeting is responsible for deciding

¹⁹² Referred to as *AktG*. This discussion focuses on the public company (*Aktiengesellschaft*). In the case of private companies (*Gesellschaft mit beschränkter Haftung*), a supervisory board is only required in two instances: if a company has more than 500 employees or if a company is involved in the metal, steel or coal industries. See Du Plessis “Werkersdeelnamen” 388.

¹⁹³ Du Plessis “Werkersdeelnamen” 387; Du Plessis “Corporate Governance Reflections on the German System” 21.

¹⁹⁴ German enterprise law consists of the sole proprietor, partnerships, private undertakings with limited liability and the public corporation (*Aktiengesellschaft*). See Du Plessis “Corporate Governance Reflections on the German System” 21; Beuthin “The Range of a Company’s Interests” 174; Du Plessis “Werkersdeelnamen” 388–391.

¹⁹⁵ See s 118(1) of the *AktG*. See also Du Plessis et al. *German Corporate Governance* 39–40 on the functions of the general meeting. See Volhard & Arndt *German Limited Liability Company (GmbH)* ch 11 on labour law of the *GmbH* and ch 12 on the supervisory board; Chew & Gillan *Corporate Governance* ch 29 on corporate ownership and control in the United Kingdom and Germany and Monks *Corporate Governance* at p 287 on the position in Germany.

¹⁹⁶ Sections 76(1), 121(2) of the *AktG*.

¹⁹⁷ Section 101(1) of the *AktG*.

on the distribution of profits within the corporation.¹⁹⁸ It is also the general meeting that will institute action against a member of the supervisory or management boards who is in breach of his duties.¹⁹⁹ Special functions can be allocated to the general meeting in the articles of association of the company.²⁰⁰

The supervisory board appoints and dismisses members of the managing board and it checks the capabilities of the members of the managing board.²⁰¹ Members of the supervisory board are appointed by the general meeting by way of a resolution passed with a simple majority of votes. Only fully competent, natural persons may serve on the supervisory board.²⁰² No person may serve on more than ten supervisory boards at the same time.²⁰³ No person is allowed to serve on the supervisory board and the management board of the same corporation.²⁰⁴ Members of both boards should conduct their affairs in a diligent manner with the necessary care.²⁰⁵

The supervisory board includes an element of co-determination by employees.²⁰⁶ It is important to note that the two-tier board structure and the system of co-determination developed separately in Germany. The two-tier board structure was already introduced in Germany in 1861²⁰⁷ and made compulsory for public companies in

¹⁹⁸ Sections 58, 173, 174 of the *AktG*.

¹⁹⁹ As far as this is not regulated otherwise. See s 147(1) of the *AktG*.

²⁰⁰ Section 119(1) of the *AktG*.

²⁰¹ This is seen as the cornerstone of the two-tier board structure. It ensures indirectly influencing decision making in public corporations. See Du Plessis "Corporate Governance Reflections on the German System" 25; Spisto "The Significance of the King Reports" 310. See Du Plessis et al. *German Corporate Governance* for a discussion on the supervisory board 65–110.

²⁰² Section 100(1) of the *AktG*.

²⁰³ Section 100(2)(1) of the *AktG*.

²⁰⁴ Section 105(1)2 of the *AktG*.

²⁰⁵ This is discussed by Du Plessis et al. *German Corporate Governance* 68.

²⁰⁶ The composition of the supervisory board is determined by the labour legislation applicable to the specific company. See also André "Some Reflections on German Corporate Governance" 1820–1849; Spisto "Stakeholder Interests in Corporate Governance" 139–141; Delpont "Werkplekforums" 415; Shandu "Shareholders' Interests" 89 regarding the composition of the two-tier board structure.

²⁰⁷ The two-tier structure was introduced by the *German Commercial Code* of 1861. See generally Du Plessis et al. *German Corporate Governance* 119.

1870. In 1922 co-determination at supervisory level was introduced. This only applied in cases where the supervisory board consisted of more than three members. Two supervisory members then had to be employee representatives.²⁰⁸ In 1934 all forms of employee participation were, however, abolished. In 1951 parity employee representation²⁰⁹ at supervisory board level was established. But the functions of the supervisory board did not change and the employees therefore had seats on a board developed for supervision by shareholders, and not employees.²¹⁰

The Co-Determination Act of 1951 made employee representation on the supervisory board compulsory for all companies within the mine (including coal), iron and steel industries. These mining, iron and steel companies are divided into three categories, namely companies with a stated share capital up to 10 million euros,²¹¹ companies with a stated share capital up to 10 and 25 million euros,²¹² and companies with a stated share capital of more than 25 million euros.²¹³ Membership on the supervisory board in companies outside of these fields is determined by the Co-Determination Act of 1976 (*Mitbestimmungsgesetz*).²¹⁴ Companies, outside of the coal, metal and steel industries,²¹⁵ who employ more than 2 000 employees must consist of an equal

²⁰⁸ This was regulated in terms of the Works Constitution Act of 1920. This Act was amended in 1922. See Official Journal of the Former Reich XVIII of 25 February 1922 (Part 1) at 209–210.

²⁰⁹ In other words, the supervisory board consists of an equal number of employee and shareholder representatives, plus one additional member who is elected by the shareholders' meeting on the proposal of the majority of both groups on the supervisory board.

²¹⁰ Du Plessis et al. *German Corporate Governance* 119–122.

²¹¹ Their supervisory boards must have 11 members, 5 must be representatives of shareholders and 5 of employees. The eleventh person should be a neutral person, who serves as chairperson.

²¹² Their supervisory boards may have 11 members in the same way as described in n 211, but these companies may determine in their articles of association that the supervisory board has 15 members, 7 representatives of shareholders, 7 of employees and the fifteenth person should be a neutral person, who serves as chairperson.

²¹³ Their supervisory boards may have 11 members in the same way as described in n 211, but these companies may determine in their articles of association that the supervisory board has 21 members, ten representatives of shareholders, 10 of employees and the last person should be a neutral person, who serves as chairperson.

²¹⁴ Du Plessis "Corporate Governance Reflections on the German System" 23–24; Du Plessis "Werkersdeelname" 387–390.

²¹⁵ These companies include public companies, private companies and companies with one or more general partner limited by shares, see s 1(1) of the Co-Determination Act of 1976.

number of labour and shareholder representatives.²¹⁶ If there is a deadlock and the shareholders and employees cannot reach consensus on a specific point, the chairperson will have a decisive vote. The chairperson is always elected by the shareholders and the employees appoint the vice-chairperson.²¹⁷ The casting vote of the chairperson makes the power balance in the supervisory board slightly in favour of the shareholders. In terms of the One Third Participation Act (*Drittelbeteiligungsgesetz*) of 2004 public and private companies with more than 500 employees must have one third employee representatives and two thirds of shareholder representatives on their supervisory boards.²¹⁸

Removal of the members of the supervisory board rests with those who appointed them, but the articles of association of the company can prescribe a different method of removal.²¹⁹ The remuneration of the members of the supervisory board is determined by the general meeting or prescribed in the articles of association.²²⁰ The remuneration should be reasonable and proportional to the functions being performed by the specific member.²²¹

The management board²²² is concerned with the day-to-day-affairs of the corporation. It should, *inter alia*, keep financial records and convene general meetings.²²³ The

²¹⁶ Section 7(1) of the *Mitbestimmungsgesetz* of 1976, hereafter *MitbestG*.

²¹⁷ Section 27 of the *MitbestG*.

²¹⁸ This Act replaced the Works Constitution Act of 1952. The rules on employee representation on the supervisory boards are similar to the 1952 Act, but simpler. Du Plessis et al. *German Corporate Governance* 118.

²¹⁹ Section 103(1) of the *AktG*. As a general rule the members of the supervisory board can be removed by a three-quarter majority of the general meeting, but the articles of incorporation may provide for a different majority.

²²⁰ Section 113(1) of the *AktG*.

²²¹ Du Plessis "Corporate Governance Reflections on the German System" 24–25; Du Plessis et al. *German Corporate Governance* 73–80 on the remuneration of the members of the supervisory board.

²²² See Du Plessis *German Corporate Governance* 40–64 for a detailed discussion of the management board.

²²³ Sections 76(1), 91, 121(2) of the *AktG*, also Havenga *Fiduciary Duties of Company Directors* 231–232. The members or shareholders enforce their rights at the general meeting (s 118(1) of the *AktG*): Du Plessis "Corporate Governance Reflections on the German System" 38–39; Du Plessis et al.

board also represents the company as far as third parties are concerned. The doctrine of *ultra vires* is unknown in the German system. The company is bound by contracts concluded with third parties even if they fall outside their scope of business. A third party may not, however, rely on the unlimited powers of the management board if he was aware of the limitation. The members of the management board are appointed by the supervisory board for a maximum period of five years.²²⁴ This period is regarded as sufficient for members to establish themselves, but not so long that they become disinterested in the management of the corporation.²²⁵ The appointment process of members of the management board is quite complex. In the first round, the members of the management board are elected by a majority of two-thirds of the supervisory board. If this majority is not achieved, a committee must be formed.²²⁶ The committee consists of the chairperson of the supervisory board, the vice-chairperson, a representative of the shareholders and an employee representative.²²⁷ This committee then has a month within which to propose suitable names to the supervisory committee. Proposals may also be made by other members of the supervisory board who are not on the committee. For the second round of elections, only a general majority is required.²²⁸ In the case of a tie the chairperson has a casting vote.²²⁹ A member of the management board may only be removed for good reasons, before the end of his term. A gross breach of duties and a lack of competence are examples of good reasons for dismissal.²³⁰ The supervisory board determines the remuneration of the members of the management board.²³¹

German Corporate Governance 41. See also Keller “Employment Relations in Germany” in Bamber et al. *International and Comparative Employment Relations*.

²²⁴ Section 84(1) of the *AktG*.

²²⁵ Du Plessis “Corporate Governance Reflections on the German System” 25 n 58.

²²⁶ Section 31(2) of the *MitbestG*.

²²⁷ Section 27(3) of the *MitbestG*.

²²⁸ Section 31(3) of the *MitbestG*.

²²⁹ Section 31(4) of the *MitbestG*. See Du Plessis “Corporate Governance Reflections on the German System” 25–26 generally.

²³⁰ Du Plessis “Corporate Governance Reflections on the German System” 26.

²³¹ Du Plessis “Corporate Governance Reflections on the German System” 27.

In November 1996 a Ministerial Draft Bill, also generally known as the *Aktienrechtsreform* 1997, was released. This Draft Bill dealt with a number of issues such as the duties, responsibilities and liability of the members of the supervisory board. After a few amendments to the Bill it was enacted law in May 1998. Amendments to German corporate law were piecemeal rather than as a result of a comprehensive reform process.²³²

c) Evaluation of the Two-Tier Board Structure

A number of corporate scandals²³³ in Germany led to considerable criticism of the two-tier board structure.²³⁴ Firstly, the most common criticism relates to the fact that major German banks dominate the supervisory boards of large German companies.²³⁵ German banks own (usually quite large) equity stakes in German public companies and are therefore representatives on the boards of those companies.²³⁶ If a major shareholder or a constituency like a bank can dominate a particular sector of the board, he or she can usually dominate the entire board.²³⁷

Secondly, employees are usually quite inactive on the supervisory boards. Therefore, they normally have limited impact on decisions reached by the board.²³⁸ Reasons for

²³² As was the case in South Africa, the United Kingdom and Australia.

²³³ The Balsam scandal was Germany's third major financial scandal in less than six months. In terms of the Balsam scheme, top managers of Balsam AG, a leading manufacturer of flooring, speculated in financial markets using borrowed funds. Two other financial scandals include the bankruptcy of the property developer Jürgen Schneider AG and the near-collapse of the big German blue-chip industrial and trading conglomerate *Metallgesellschaft* AG. These companies have also been involved in allegations of fraud or derivatives speculation.

²³⁴ This criticism is mainly of the supervisory boards, seeing that they should oversee the business of the company. See Du Plessis "Corporate Governance Reforms in Germany" 389; Du Plessis et al. *Principles of Contemporary Corporate Governance* 307–308; Du Plessis "The German Two-Tier Board" 1139.

²³⁵ André "Some Reflections on German Corporate Governance" 1822.

²³⁶ André "Some Reflections on German Corporate Governance" 1834. Deutsche Bank alone is a representative on more than 400 supervisory boards.

²³⁷ André "Some Reflections on German Corporate Governance" 1828.

²³⁸ See André "Some Reflections on German Corporate Governance" 1827 who refers to an article by Henry Hansmann where it is stated that "[c]o-determination does not generally seem to have resulted in effective worker participation in control of the corporation at the board level; rather, control

this apathy may be that the interests of the employees and the shareholders are not necessarily that different, especially when the company is prospering. Employees and shareholders then want what is best for the company. Furthermore, employees are sometimes not involved in decision making. Some decisions are made outside the formal board meetings and only presented to the board as a formality; others have already been made by the management board and are only ratified by the supervisory board.²³⁹ Employee representatives on the supervisory board usually have no influence on the day-to-day activities of the management board, such as appointments and dismissals of employees, training offered, working hours and holidays.²⁴⁰ These issues are, however, important to them. Works councils have therefore been established, in terms of the *Betriebsverfassungsgesetz* (Works Constitution Act) of 1972. In terms of this Act, all companies with more than five employees are compelled to have a works council, irrespective of their field of activity. Works councils have a considerable say concerning the shop floor and the matters that affect employees the most. The works council therefore represents the interests of the employees. Employees would rather participate through works councils. Their role as representatives on board level is therefore only an add-on and even leads to duplication in some instances.²⁴¹

The above conclusion that employees do not necessarily benefit from being represented on the supervisory board leads to the argument that the two-tier system is not necessarily the most suitable option for employee participation in South African companies. Other options to provide employees with the necessary protection without necessarily opting for the two-tier structure also have to be explored. It has, furthermore been argued that the supervisory board is ineffective. Some

essentially remains in the hands of the investors” and “employees are usually quite inactive on the supervisory board and have relatively little impact on substantive decisions reached by the board. The two-tier structure does therefore not necessarily provide the solution for increased employee participation”. See further O’Regan “Possibilities for Worker Participation” 128 who refers to research in Germany that indicates that worker participation on board level is unlikely to lead to worker interests being powerfully put forward at board level.

²³⁹ André “Some Reflections on German Corporate Governance” 1827.

²⁴⁰ André “Some Reflections on German Corporate Governance” 1827.

²⁴¹ Lutter “The German System of Worker Participation” 155–159.

commentators suggest that the members of the supervisory board do not take their task seriously enough. They only meet a few times a year, making it difficult to fulfil their functions properly.²⁴²

Thirdly, the relationship between the supervisory board and the management board has also been criticised.²⁴³ The supervisory board must provide the management board with advice. By implication the management board has an obligation to allow the supervisory board to provide it with advice. This leads to many questions concerning the rights and duties of the respective boards, for instance, whether or not the supervisory board can really act as an advisor to the modern, professional management board of large corporations. Moreover, the supervisory board has to rely fully on the information that it obtains from the management board and this information is not always adequate or comprehensive enough.²⁴⁴

These points of criticism relating to the relationship between the supervisory and management boards, and the issue of the ineffectiveness of the supervisory board, have been substantially addressed in recent German corporate law reforms.²⁴⁵

In May 2000 a government commission was appointed chaired by Theodor Baums. Its recommendations led to the publication of the *Corporate Governance Code for Listed German Corporations*. The code was adopted in February 2002.²⁴⁶ The code is voluntary and based on a “comply or explain” principle. This principle is entrenched

²⁴² Du Plessis “Corporate Governance Reflections on the German System” 42; Du Plessis et al. *Principles of Contemporary Corporate Governance* 308.

²⁴³ Du Plessis “Corporate Governance Reforms in Germany” 389.

²⁴⁴ Du Plessis “Corporate Governance Reflections on the German System” 42.

²⁴⁵ See Du Plessis “The German Two-Tier Board” 1140. See par 3 (cooperation between the management board and the supervisory board), pars 4–5 relating to the tasks and duties of the management and supervisory boards as well as the composition of these boards in the *Corporate Governance Code for Listed German Corporations*. See generally Du Plessis “Corporate Governance Reforms in Germany” 389; Du Plessis et al. *Principles of Contemporary Corporate Governance* 309–312.

²⁴⁶ The code was reviewed in June 2007.

in legislation.²⁴⁷ The code represents essential regulations for the management and supervision of German listed companies. The code is aimed at making the German corporate governance system transparent and understandable. The code confirms that the management board is responsible for managing the enterprise and that the supervisory board appoints, supervises and advises the members of the management board.²⁴⁸

The relationship between the supervisory and management boards is now clearly stipulated in paragraph 3 of the code. It states, *inter alia*, that these two boards should co-operate closely to the benefit of the company. The functions of both the management board and supervisory boards are also listed in the code.²⁴⁹ The amendments to the Act and the introduction of the *Corporate Governance Code for Listed Corporations*,²⁵⁰ discussed above, broaden the rights of the supervisory board considerably.²⁵¹ It can now insist that the management board report to it on the extent of any deviations from the original business plan of the specific company. Providing sufficient information is also the joint responsibility of the management and supervisory boards.²⁵²

Lastly, the two-tier system can operationally be more tedious because the shareholders and employees sitting on the supervisory boards can delay the reaching of consensus. Decisions are taken with more speed when a unitary board structure is used.²⁵³ The more parties that are involved, the more difficult it is to reach consensus.

²⁴⁷ Section 161 of the *AktG*. See generally, Du Plessis “The German Two-Tier Board” 1139 for a detailed discussion of the code.

²⁴⁸ Foreword of the code.

²⁴⁹ See pars 4 and 5 of the code.

²⁵⁰ This code is available at http://www.ikb.de/content/en/ir/corporate_governance/030521_Corp_Gov_E.pdf (accessed 10 August 2006). See André “Some Reflections on German Corporate Governance” 1822 for a discussion of the corporate governance reform in Germany.

²⁵¹ Davies “Employee Representation” 137.

²⁵² Paragraph 3.3 of the code.

²⁵³ Shandu “Shareholders’ Interests” 93.

The two-tier system has the advantage that many parties are involved at supervisory level and thus reducing the risk for strategic mistakes.

d) Conclusions: The Unitary Board Structure Versus the Two-Tier Board Structure

From the above it is clear that, first, the board of directors in the unitary structure is similar to the supervisory board in the two-tier structure and the managing directors in the unitary board are similar to the management board in the two-tier structure. I suggest that the addition of non-executive directors on the board of directors in the unitary structure brings the unitary board even closer to the two-tier structure. The supervisory board in a two-tier structure is independent and separate from the management board. The inclusion of non-executive directors on the unitary board of directors ensures similar independence and separateness on a unitary board.

Second, the board of directors in the unitary structure and the supervisory board in the two-tier structure are both appointed by the shareholders. The supervisory board also appoints the management board and the board of directors the relevant managing directors. It can therefore be argued that unitary boards and two-tier boards are not really alternatives to each other, but rather two board structures with differences and similarities.

Third, information flows more easily in the unitary board structure and there is a closer relation between those supervising and those managing. The two-tier structure provides a stricter separation between the supervision and management functions.

Fourth, the main difference between the two-tier structure and the unitary structure is that in the unitary structure the managing directors also serve on the board of directors. In South Africa, it is recommended that the managing director be a non-executive director.²⁵⁴ In the two-tier structure members of the supervisory board are not allowed to sit on the management board and *vice versa*. The supervisory board

²⁵⁴ See p 53 in *King II*.

also includes the element of co-determination (employee participation at supervisory board level).²⁵⁵

Fifth, when one considers these two structures in trying to find the most appropriate structure for a particular country, the history, circumstances of, and current situation in, that country are very important.²⁵⁶ This is especially true in South Africa, which has had a new political dispensation since 1994.²⁵⁷ When considering foreign systems, it must be taken into account that labour relations in a particular country are usually the product of political, socio-economical and historical factors in that country. This means that the transplantation of legal rules from one system to another will not necessarily provide the same results.²⁵⁸

It would seem that the proponents of a stakeholder or pluralist approach are usually in favour of the two-tier board structure, especially due to the co-determination element. In terms of the pluralist approach directors should consider the interests of stakeholders when managing a company and by having employee representation on boards this consideration of stakeholder interests (especially employee interests) would be easier. It also seems as if those who favour the enlightened shareholder value or shareholder primacy approach usually favour a unitary board structure where employees are not represented on the board.²⁵⁹

²⁵⁵ See Du Plessis et al. *Principles of Contemporary Corporate Governance* 58–63, who also provide illustrations on the operation of the traditional unitary board, the modern unitary board and the two-tier board. See also Delpont “Werkplekforums” 417–418; Du Plessis “Corporate Governance Reforms in Germany” 389.

²⁵⁶ Du Plessis et al. *Principles of Contemporary Corporate Governance* 58–63.

²⁵⁷ Paragraph 1 above.

²⁵⁸ O'Regan “Possibilities for Worker Participation” 122.

²⁵⁹ See Shandu “Shareholders’ Interests” 93 where he states the following: “The main difference between the two models is that the Anglo-Saxon model is traditionally directed at maximising shareholder value (*thus the enlightened shareholder value approach*) whereas the two-tier board seeks to balance the interests of both the shareholders and the stakeholders (*thus the pluralist approach*) (emphasis added). As indicated above, the two-tier board structure is, however, not always linked to the pluralist approach. See also Spisto “The Significance of the King Reports” 310; André “Some Reflections on German Corporate Governance” 1827. See pars (e) and (f) below for the advantages and disadvantages of the two-tier board structure. It is stated in the *Policy Document* that the two-tier board provides the opportunity for stakeholder representation: at ch 4 par 4.4.2. Those in favour of the unitary board structure are generally in favour of the enlightened shareholder value approach; see the position of Business South Africa in the *February 2005 NEDLAC Report* annexure 2 par 4.4.2. See

A simple link between the two-tier board structure and a model in favour of the protection of stakeholders or a unitary board structure and a model advocating for shareholder primacy is, however, not always easy to identify. Countries usually make use of a mixture of models. It would seem that the stakeholder model is favoured in Germany, and this is particularly true if the supervisory board consists of shareholders and employees in a 50:50 ratio.²⁶⁰ In such cases, shareholders' interests will not receive priority, but they will be equal to the interests of employees.²⁶¹ The co-determination element on the German two-tier board can therefore be seen as indicative that the pluralist approach is preferred, but only to a limited extent as only one group, namely employees, is favoured. Other interest groups such as consumers and suppliers are excluded. The pluralist approach, if properly applied, implies that directors should have direct fiduciary duties towards a number of interest groups, and not only to employees.

It is important to note that the two-tier board structure is not necessarily linked to the pluralist approach. The *German Corporate Governance Code*²⁶² states that the management board should manage the enterprise independently, and is obliged to do so in the best interests of the enterprise.²⁶³ This indicates that the enlightened shareholder value approach, where directors should exercise their fiduciary duties for the benefit of the company as a whole, is preferred.

To summarise: the two-tier system, as applied in Germany, provides employees with protection, but ignores other stakeholders, such as suppliers and consumers. Proper

further generally Dine "Company Law Developments" 245; Botha "Confusion in the King Report" 29–39. See ch 2 par 5.1 on the pluralist and enlightened shareholder value approaches.

²⁶⁰ In German law this would be the case concerning all companies within the coal, steel and metal industries that have more than 1 000 employees (in terms of the *Montan-Mitbestimmungsgesetz* of 1951) or companies with more than 2 000 employees that must consist of an equal number of labour and shareholder representatives (in terms of the *Mitbestimmungsgesetz*). See par (b) above.

²⁶¹ See the discussion above on the different type of companies in Germany and when the chairperson will have a casting vote.

²⁶² Available at http://www.ikb.de/content/en/ir/corporate_governance/030521_Corp_Gov_E.pdf (accessed 10 August 2006).

²⁶³ Paragraph 4.1.1 of the code.

justification is needed to provide only employees, and not other interest groups, with protection. One could argue that other stakeholders can be adequately protected receive by way of contracts and other legislation.²⁶⁴ Whether this is the case in a particular legal system will have to be investigated.

This issue of employee protection in South Africa was considered in *King I* and *King II* as well as the *Policy Document*. The views expressed in these documents are discussed below. The Draft Companies Bill of 2007 does not provide employees with direct protection and opts for a unitary board structure. This is discussed in paragraph 4.3 below.

e) Worker Participation in South Africa

King I confirmed that the unitary board structure has always been applied in South Africa and that the personal interaction associated with the unitary structure is one of the main advantages of this structure.²⁶⁵ The committee also addressed the issue of worker participation at board level.²⁶⁶ Firstly, a company is a *nexus* of inter-relations between its various stakeholders. Therefore, all stakeholders are entitled to representation at board level. One cannot exclude certain stakeholders, but it will be impractical to have all stakeholders represented on the board. Secondly, the committee believed that workers should be involved in the corporate governance of a company, because by involving them resources and skills would be pooled together to ensure that the company survives and thrives. It is stated that the basic element of good governance is to make decisions honestly in the best interests of the company. A worker representative would have to act with intellectual honesty even if it is a difficult decision for an employee to make.²⁶⁷ Thirdly, a system of worker participation should grow out of the company's business, culture and the workers'

²⁶⁴ For example, creditors are protected by way of insolvency law and shareholders can draw up a shareholders' agreement with the company. See, generally, Sealy "Directors' Wider Responsibilities" 173.

²⁶⁵ *King I* ch 4 par 11.

²⁶⁶ *King I* ch 4 par 12.

²⁶⁷ *King I* ch 4 par 12.5.

organisation. Companies should therefore develop their own system of worker participation by way of workers' committees, or at management or board level.²⁶⁸

In *King II* it was reiterated that the unitary board structure is the preferred option.²⁶⁹ The committee also favoured the enlightened shareholder value approach, as it creates the necessary balance between economic efficiency and the broader objectives of society.²⁷⁰ It recommended that executive and non-executive directors should serve on boards.²⁷¹ An executive director is involved with the day-to-day business of the company, and a non-executive director is not a full-time director and is not involved with the day-to-day management of the company.²⁷² A non-executive director should therefore be independent from management.²⁷³ The committee further recommended that the majority of directors should be non-executive directors.²⁷⁴

The drafters of the *Policy Document* also favoured the “triple-bottom line” approach and thus the enlightened shareholder value approach.²⁷⁵ They favoured the unitary

²⁶⁸ See *King I* ch 4 pars 12.1–13.3.

²⁶⁹ *King II* s 1 ch 1 par 1.

²⁷⁰ They refer to it as the “triple-bottom line” or the “inclusive approach”; see *King II* par 17; the *Executive Summary of King II* pars 17, 37. See also Shandu “Shareholders’ Interests” 93.

²⁷¹ *King II* s 1 ch 4; *Executive Summary of King II* par 2.1.2. The reports state that non-executive independent directors have also evolved in practice. Such a director is a non-executive director who is not a representative of a shareowner, is not employed by the company, is not a member of immediate family of an individual who is or has been in the past three years employed by the company, is not a professional advisor or significant supplier of the company, has no contractual relationship with the company and is free from any relationship that can materially interfere with the individual’s capacity to act in an independent manner (*King II* s 1, ch 4, par 7.3)

²⁷² *King II* s 1 ch 4.

²⁷³ *King II* s 1 ch 4; *Executive Summary of King II* par 2.4.3. It is specifically stated that non-executive directors should be individuals of calibre and credibility who have the necessary skill and experience to make decisions independent from the management (see par 2.4.2 of the *Executive Summary of King II*). See generally Spisto “The Significance of the King Reports” where he provides reasons why he is in favour of the two-tier board structure. He also refers to *King I* and *King II* and the *Policy Document*, and suggests that they do not provide valid reasons why they are not in favour of the two-tier structure, at 338, 339. I submit that their reasons are valid.

²⁷⁴ *King II* s 1 ch 1 par 3.

²⁷⁵ The *Policy Document* ch 3 par 3.2.3.

board structure with optional stakeholder representation.²⁷⁶ The following reasons were provided for using the unitary board structure rather than the two-tier structure: the two-tier structure is often inefficient;²⁷⁷ it may deter investors; and it is not necessarily desirable for all stakeholders.²⁷⁸

A two-tier structure may deter investors for various reasons. Investors are usually interested in wealth maximisation and the involvement of employees on board level can prevent that. As stated above, the number of parties involved may delay decision making. Imposing a new structure will also be costly, especially in respect of paperwork involved when converting to another system.²⁷⁹

It is submitted that the advantages of a two-tier board structure, namely supervision and independence, can also be achieved in the unitary structure, especially with the inclusion of non-executive and independent directors.²⁸⁰ In Germany the co-determination aspect of the supervisory board in the two-tier system has proved to be unsuccessful mainly due to inactive employees.

f) Conclusions

In terms of the traditional position that directors must act in the best interests of the company, worker participation on boards can be problematic. Conflicts of interest

²⁷⁶ The *Policy Document* ch 4 par 4.4.2; *February 2005 NEDLAC Report* par 6.3.16, annexure 2 par 4.4.2.

²⁷⁷ This reason has been discussed above. See *the Policy Document* par 4.4.2.

²⁷⁸ The *Policy Document* ch 4 par 4.4.2; Havenga “Regulating Directors’ Duties” 617 note 39.

²⁷⁹ The *Policy Document* ch 4 par 4.4.2. Business supports the drafters of the *Policy Document*, Labour is also in favour of a unitary board, but recommends the inclusion of non-executive directors to represent key stakeholders, *February 2005 NEDLAC Report* annexure 3 par 4.4.2; Spisto “Stakeholder Interests in Corporate Governance” 129–147 states (at 147): “Thus, the most desirable option is a model which represents the best economic efficiency after balancing the economic benefits and the cost of introducing the new model. It is also highly recommended that the workers’ involvement in corporate governance be increased to a significant level. It is along these lines that a new model of corporate governance for South Africa has been proposed.” It is uncertain how one will give effect to these ideas practically.

²⁸⁰ See also Delpont “Werkplekforums” 418; Du Plessis “Werkersdeelname” 391–392; *King I* at ch 4 par 10 where it is suggested that “every objective of the two-tier structure can also be attained in a unitary structure”.

may arise between employees and shareholders.²⁸¹ For example, where a company is in financial difficulty, the directors may have to choose between the employees and the shareholders. Shareholders may be protected by making some of the employees redundant. This will obviously not be in the interest of the employees.

The two-tier board structure has merit,²⁸² but the co-determination element has some shortcomings. I submit that the two-tier structure is not the best option for increased stakeholder (especially employee) protection in South Africa. There are other options that will increase employee participation, without changing fundamental principles of company law and that are less costly. These options are discussed below. Delpont and Du Plessis confirm that, in practice, South African law is in any event very similar to German company law in respect of larger public companies. The board of directors does not actually handle the day-to-day business affairs of the company. This is left to managers who are appointed by the board. The only difference is that in South Africa the managing director is also a member of the board. Should a director be an employee and he or she has a conflict of interest between the interests of the employees and those of the company, that director should preferably abstain from voting.²⁸³ Increased participation on the boards by specific interests groups may hamper directors' attempts to conduct the company's affairs in an effective manner.²⁸⁴ It therefore seems that the unitary board structure is the preferred option.

In chapter 2 it was argued that stakeholders should be protected, but directors have to bear the circumstances of each specific case in mind when determining in whose interests they should manage the company. The protection that a stakeholder receives in other legislation should play a role when courts balance the interests of different

²⁸¹ Hodes "The Social Responsibility of a Company" 480. See also Mackenzie "The Employee and the Company Director" 689. This is also discussed in ch 2 par 5.2 above where a proposed theory is suggested.

²⁸² Du Plessis "Corporate Governance Reflections on the German System" 44.

²⁸³ See the discussion on workplace forums below. Delpont "Werkplekforums" 418; Du Plessis "Werkersdeelname" 391–392.

²⁸⁴ Beuthin "The Range of a Company's Interests" 174; see generally Du Plessis "Werkersdeelname" 387–393.

stakeholders.²⁸⁵ The board of directors usually “supervises” the managers and the inclusion of non-executive directors increases independence of the board. The unitary structure does not necessarily imply the loss of the advantage of supervision. Employee participation can be achieved in other ways than by a two-tier structure.²⁸⁶ In the South African unitary board structure directors should manage the company in the best interests of the company as a whole.²⁸⁷ This does not mean that stakeholder interests will be disregarded. Employees, for example, would still be able to voice their opinions in workplace forums or through collective bargaining.²⁸⁸ Directors will also consider their interests, because it would usually be to the benefit of the company to do so. Employees can also be directors and executive directors are usually employees, and will therefore be able to serve on the unitary board. This can lead to a conflict of interests. Directors should, however, abstain from voting in such cases.²⁸⁹

3.3.2.2 Workplace Forums

Stakeholders can be protected by statutes other than company statutes. Protection by way of legislation aimed at particular groups would arguably achieve better protection than to broaden the fiduciary duties of directors.²⁹⁰ I argue that the protection of employees should rather be regulated in legislation dealing with labour law issues.

In South Africa the Labour Relations Act (as amended)²⁹¹ is the main statute dealing with labour relations. It came into operation on 13 December 1995.²⁹² The purpose

²⁸⁵ See ch 2 par 5.2 above.

²⁸⁶ Even in Germany, where the two-tier system is well established, there is currently debate on whether or not employees should participate on the supervisory board. See Du Plessis et al. *Principles of Contemporary Corporate Governance* 62.

²⁸⁷ The *Policy Document* ch 4 par 4.4.2; the *Executive Summary of King II* par 2.1. Havenga “Regulating Directors’ Duties” 617.

²⁸⁸ See pars 3.3.2.2, 3.3.2.3 below.

²⁸⁹ See Delport “Werkplekforums” 418 in this regard.

²⁹⁰ The *Policy Document* ch 3 par 3.2.3; Havenga “Directors’ Fiduciary Duties Under our Future Company-law Regime” 321; Havenga “Regulating Directors’ Duties” 615.

²⁹¹ Act 66 of 1995 (hereafter the Labour Relations Act).

statement of the Act²⁹³ makes it clear that the Act is there to promote, *inter alia*, orderly collective bargaining and employee participation in decision making in the workplace.²⁹⁴

The Labour Relations Act introduced workplace forums. They seek to establish worker participation. Section 79 of the Labour Relations Act provides for the general functions of workplace forums and provides that they should seek to promote the interests of all employees in the workplace, whether or not the employees are trade union members, enhance efficiency in the workplace, are consulted by the employer with a view to reaching consensus regarding the matters listed in section 84 or participate in joint decision making concerning the issues in section 86.²⁹⁵ Workplace forums should therefore promote company management where employees participate rather than adversarial bargaining within a particular enterprise. Workplace forums are “in-house” institutions operating within a particular company or division, and therefore differ from trade unions. They provide a framework within which employers and employees (or their representatives) jointly solve their problems. Workplace forums are not alternatives to trade unions, but are there to promote participative management through consultation and joint decision making.²⁹⁶ A workplace forum may be established in any workplace, where there are more than one hundred employees.²⁹⁷

²⁹² In August 1994 the government appointed a task team to draft a new Labour Relations Act. In February 1995 the Labour Relations Act of 1995 was passed by Parliament and it came into operation on 11 November 1996. The Basic Conditions of Employment Act 75 of 1997 and the Employment Equity Act 55 of 1998 followed. A review was launched in 1999 by the government concerning the Labour Relations Act and the Basic Conditions of Employment Act (mainly due to a decrease in foreign direct investments and high levels of unemployment). In July 2002 draft Bills were published to amend these Acts. They were promulgated on 1 August 2002. See Du Toit et al. *Labour Relations Law* 5–51.

²⁹³ Chapter 1 of the Labour Relations Act.

²⁹⁴ It also regulates, *inter alia*, strikes and lockouts and the establishment of labour courts. See Du Toit et al. *Labour Relations Law* ch V.

²⁹⁵ Du Toit et al. *Labour Relations Law* 326. These sections are further discussed below.

²⁹⁶ See Grogan *Workplace Law* 293.

²⁹⁷ Du Toit et al. *Labour Relations Law* 326.

The distinction between consultation and joint decision making is important.²⁹⁸ Most of the issues that a workplace forum can negotiate on only require “consultation”.²⁹⁹ Consultation suggests that the employer should notify the forum of any proposals and consider their suggestions in good faith.³⁰⁰ Section 84(1) lists the matters that the workplace forum must consult on. These matters include changes in organisation of work, job grading, education and training, export promotion, and product development plans. Before an employer may implement a proposal in relation to any of these matters, the employer must first consult with the workplace forum and try to reach consensus. An agreement is, however, not necessary. Directors cannot be forced to accept a decision made at a workplace forum (on section 84(1) issues) because the workplace forum only has to be consulted on the specific issue.³⁰¹ Only those aspects listed in section 86 require joint decision making or an agreement. For instance, any proposals concerning disciplinary codes and procedures, and rules relating to the proper regulation of the workplace other than work-related conduct should be agreed on.³⁰² Joint decision making goes further than consultation in the sense that an employer may not implement any proposal without the forum’s consent.³⁰³

The establishment of workplace forums in the Labour Relations Act enhances the protection of employees. Workplace forums achieve the same results as co-

²⁹⁸ Section 79 of the Labour Relations Act.

²⁹⁹ Du Toit et al. *Labour Relations Law* 340–341.

³⁰⁰ Section 85 of the Labour Relations Act; Grogan *Workplace Law* 296.

³⁰¹ Du Toit et al. *Labour Relations Law* 327; Grogan *Workplace Law* 296–298.

³⁰² Section 86 (1) states that:

Unless the matters for joint decision-making are regulated by a collective agreement with the representative trade union, an employer must consult and reach consensus with a workplace forum before implementing any proposal concerning (a) disciplinary codes and procedures; (b) rules relating to the proper regulation of the workplace in so far as they apply to conduct not related to the work performance of employees; (c) measures designed to protect and advance persons disadvantaged by unfair discrimination; and (d) changes by the employer or by employer-appointed representatives on trusts or boards of employer-controlled schemes, to the rules regulating social benefit schemes.

³⁰³ Section 85 of the Labour Relations Act; Grogan *Workplace Law* 297.

determination on the German two-tier board.³⁰⁴ The enlightened shareholder value approach (or an approach mainly based on shareholder primacy) can be problematic with regard to workplace forums. This can be explained as follows: should a decision made at a workplace forum on issues listed in section 86 be to the detriment of the company and to the benefit of the employees, directors may be liable for a breach of their fiduciary duties.³⁰⁵ They will be personally liable as their fiduciary duties are still owed to the company and not to other stakeholders directly. It is, however, important to distinguish between consultation and joint decision making, when considering possible personal liability of a director in terms of matters provided for in sections 84 and 86. Should a director be liable for a breach of his fiduciary duties due to a decision taken by the company after a decision by the workplace forum on a section 84 matter, the forum cannot be blamed. Rather, the specific director will be held accountable based on his own breach of duty, because he does not have to accept anything decided at the workplace forum.³⁰⁶ The director would be in breach of his fiduciary duties if he accepts something that is to the detriment of the company. Section 86 issues³⁰⁷ require joint decision making and not consultation. Directors may be personally liable if the company acts to the employees' benefit on issues listed in section 86, but to the detriment of the company, following a decision made in the workplace forum.³⁰⁸ It is therefore important that directors protect their own interests. They may, for example, record their dissent on a decision. Whether this will have the effect of relieving a director from personal liability is difficult to tell. One will have to wait and see whether a director will be held accountable when he ratifies a decision made in the workplace forum that was not in the best interests of the company as a whole.

³⁰⁴ Paragraph (b) above.

³⁰⁵ Havenga "Directors' Fiduciary Duties Under our Future Company-law Regime" 323; Delpont "Werkplekforums" 417.

³⁰⁶ On matters listed in s 84(1) of the Labour Relations Act.

³⁰⁷ For instance, any proposals concerning disciplinary codes and procedures and rules relating to the proper regulation of the workplace other than work-related conduct should be agreed on.

³⁰⁸ As indicated by Delpont "Werkplekforums" 417.

When determining whether workplace forums protect employees, it is important to note that these forums are currently not widely implemented in South Africa.³⁰⁹ The main reason for this is the fact that the Congress of South African Trade Unions (Cosatu) is opposed to these forums. It contends that these forums will clash with its shop steward committees and threaten trade union organisation.³¹⁰ It also fears these forums will undermine its independence and its traditional adversarial role in collective bargaining.³¹¹ There are no reported cases dealing with workplace forums.

3.3.2.3 *Collective Bargaining*

Collective bargaining is also a method of protecting employees' interests and of ensuring worker participation in decision making. It relates to the process whereby trade unions and management negotiate terms and conditions of employment.³¹² Collective bargaining happens between employers and trade unions concerning matters of mutual interest rather than "rights disputes". The Labour Relations Act does not define these forms of dispute. It is, however, generally accepted that a "dispute of interest" arises when a party claims a benefit to which it is not entitled by law, while "rights disputes" occur when parties cannot agree whether one of them is legally entitled to a benefit.³¹³ Chapter III of the Labour Relations Act relates to collective bargaining. Part A of chapter III deals with organisational rights such as the trade unions' right to access to the workplace, and the right of an employee to authorise an employer to deduct his subscription levy from his salary.³¹⁴ It also deals with trade union representatives. The number of employees indicates the number of

³⁰⁹ As indicated by labour law practitioners: Steenkamp et al. "The Right to Bargain" 958; Du Toit et al. *Labour Relations Law* 42.

³¹⁰ Du Toit et al. *Labour Relations Law* 42.

³¹¹ Steenkamp et al. "The Right to Bargain" 958.

³¹² O'Regan "Possibilities for Worker Participation" 114–119. A "collective agreement" is defined in s 213 of the Labour Relations Act as "[a] written agreement concerning the terms and conditions of employment or any other matter of mutual interest concluded by one or more registered trade unions, on the one hand and, on the other hand – one or more employees".

³¹³ Grogan *Workplace Law* 293. "Right disputes" are about the interpretation or application of existing rights. "Disputes of interest" arise due to a failure to agree on a new term or condition of employment. See *Ceramic Industries Ltd v NCBWU (1)* (1997) 18 ILJ 716 (LC) on these definitions.

³¹⁴ Sections 12, 13 of the Labour Relations Act.

representatives allocated to them. For example, if there are ten employees who are members of a trade union, they will be allocated one representative.³¹⁵ Part B concerns collective agreements, their legal effect and the procedures to be followed concerning disputes over these agreements.³¹⁶ Part C regulates the establishment, powers, functions, registration and constitution of a bargaining council. One or more registered trade unions may establish a bargaining council for a specific sector.³¹⁷

Collective bargaining as a form of worker participation has some limitations. For instance, unions often bargain from a position of ignorance, since they do not always have the relevant information to place them in a superior bargaining position. Chapter III, section 16 specifies the type of information that an employer must disclose in order for the trade unions to be able to perform their functions effectively. This section states, for instance, that an employer is not required to disclose information which is legally privileged.³¹⁸

Collective bargaining cannot fully meet the needs of the employees. The process of collective bargaining usually accepts that management is the decision-maker and merely attempts to influence those decisions by negotiation.³¹⁹ In practice, employers and trade unions usually engage in collective bargaining as a result of some decision made by management, with which the employees are not happy. Collective

³¹⁵ Section 14 of the Labour Relations Act.

³¹⁶ Sections 23–26 of the Labour Relations Act.

³¹⁷ Sections 27–34 of the Labour Relations Act. Part D concerns bargaining councils in the public sector and part E statutory councils. These provisions are not important for purposes of this thesis.

³¹⁸ No definition or explanation is provided on what constitutes “legally privileged” information. However, see Schmidt et al. “Civil Procedure” in *LAWSA* vol 9 par 751 on privilege. It must be claimed by the person in whom it vests. Professional privilege has a wide ambit: a party with a right to such a privilege may not only claim it when such a party testifies, but the party may also prevent his or her legal advisor or agent from making disclosures. An employer is also not required to disclose information that is confidential, and if disclosed, may cause substantial harm to the employee or employer. If there is a dispute on whether or not certain information is required to be disclosed, any party may refer this dispute to the Commission, see s 16(5) of the Labour Relations Act. Sections 11–13 of the Promotion of Access to Information Act provide for the right of access to certain information. Sections 33–46 concern grounds for the refusal of access to information, for example, mandatory protection of commercial information of a third party. See Le Roux “Access to Information” 101–110.

³¹⁹ O’Regan “Possibilities for Worker Participation” 118–119.

bargaining is reactive and not proactive. It is, therefore, not really the correct vehicle to facilitate joint decision making of workers, but rather a mechanism to negotiate on the terms and conditions of employment.³²⁰

It has, however, been stated that it is not just the workers that will benefit from collective bargaining. Management can also benefit:

[T]he principal interest of management in collective bargaining has always been the maintenance of industrial peace over a given area and period, and...the principal interest of labour has always been the creation and the maintenance of certain standards over a given area and period, standards of distribution of work, or rewards, and of stability of employment.³²¹

3.3.3 Conclusions

A company is managed by its directors. This should be done in the best interests of the company as a separate legal entity. A director should balance various interests when making decisions concerning the company. The protection that stakeholders receive in other legislation is important when balancing the various interests of different stakeholders. In determining how directors should balance the interests of different stakeholders the fact that employees are protected in other legislation will therefore be an influential factor.³²²

Different means of ensuring that employees are adequately protected were explored above. Worker participation on board level does not seem to be the preferred route in South Africa.³²³ There are two main reasons for this. First, in a unitary board structure, a conflict of interest may arise when a director is also an employee.³²⁴ The two-tier board structure that allows for worker participation has proved not always to

³²⁰ Grogan *Workplace Law* ch 20; Du Toit et al. *Labour Relations Law* ch V; Steenkamp, Stelzner & Badenhorst “The Right to Bargain” 959.

³²¹ Davies & Freedland *Kahn-Freud’s Labour and the Law* as per O’Regan “Possibilities for Worker Participation” 117.

³²² See the proposed theory in ch 2 par 5.2 above.

³²³ Paragraph 3.3.2.1.

³²⁴ This issue can be solved if those directors just abstain from voting as indicated by Delpont in “Werkplekforums” 418.

be effective, especially in Germany where employees are usually inactive and more concerned with decisions taken at plant level by works councils.³²⁵ The fact that employees are not the only other interest group is another reason not to have worker participation on board level. It will be impractical to provide creditors, consumers, suppliers and the general public with board representation, and there is no good reason why employees should receive preferential treatment. Another option available is to give effect to worker participation in workplace forums.³²⁶ The concern that a decision, which is not in the best interests of the company can be taken at the forum, is not well founded, especially on section 84 matters where only consultation is required.³²⁷ An employer must allow the workplace forum an opportunity to voice its opinions. On most issues, the forum's consent or agreement is not required.³²⁸

Collective bargaining is also a means of worker protection.³²⁹ It obliges management to consider issues that are important to employees. It has been admitted that collective bargaining has shortcomings, but it provides a platform for employees to voice their concerns through their trade union representatives with regard to their terms and conditions of employment.

Lastly, employees can also be directors. This is usually so in the case of managing directors in particular. If a director is also an employee, he will usually have a contract of employment with the company concerned.³³⁰ A director's position as such is totally independent from his position as an employee.³³¹ Should there be a conflict

³²⁵ Paragraph 3.3.2.1 above.

³²⁶ Paragraph 3.3.2.2.

³²⁷ Section 84 of the Labour Relations Act.

³²⁸ Section 84 (1) of the Labour Relations Act.

³²⁹ Paragraph 3.3.2.3.

³³⁰ Cilliers & Benade *Corporate Law* 166.

³³¹ *Peens & Swart v MKTV Beleggings Beherend BK & Another* 2003 (3) ALL SA 426 (T); *Rosebank Television & Appliances Co (Pty) Ltd v Orbit Sales Corp (Pty)* 1969 (1) SA 300 (T) at 303.

of interests, the specific director should abstain from voting.³³² The specific director does not, however, represent a specific group of employees when casting his vote as an employee.

3.4 Other Stakeholders

3.4.1 Introduction

The bulk of authorities deals with directors' fiduciary duties towards individual shareholders, creditors and employees of a company. Nonetheless, there are other interest groups who also need to be considered. In this section consumers and suppliers are discussed as examples of such specific interest groups .

A company has commercial relationships with consumers and suppliers.³³³ It can be argued that consumers have a right to be included as beneficiaries when directors exercise their fiduciary duties, since they are the people who buy and use the company's products. It has been suggested that directors should have a duty towards consumers not to impose excessive prices and to produce goods of a good quality.³³⁴ However, the counter-argument is that if a consumer is not satisfied with a company's approach or if the company charges too high prices, the consumer does not have to support the company. A company's approach towards consumers will have an effect on the profits of the company over the long and medium term. If the company acts in a fair and reasonable manner towards consumers, they will keep on supporting the company.³³⁵

³³² Cilliers & Benade *Corporate Law* 166.

³³³ Hodes "The Social Responsibility of a Company" 482.

³³⁴ Beuthin "The Range of a Company's Interests" 170.

³³⁵ See also ch 3 par 3.1.5 where the possible reasons why consumers need protection in the United Kingdom context are discussed. These reasons are also relevant in the South African context and include the fact that consumers need to be protected from fraudulent trading practices. Not all consumers have the necessary skill and knowledge to make informed decisions on what to purchase. Advertising and marketing strategies are very sophisticated, and can result in misleading or confusing information being provided to consumers. Consumers are generally awarded with credit and they also have high disposable incomes.

The relationship between a company and its suppliers is also important. If the company uses the specific suppliers often and treats them well, it may result in possible discounts for the company. Suppliers will also provide good service if they have an ongoing and good relationship with the company. For example, the supplier will ensure the timely delivery of goods and the availability of staff when there is a crisis, such as a strike at the offices of the specific supplier.

It can therefore be argued that it may be in the best interests of the company as a whole for directors to consider the interests of consumers and suppliers. Specific legislation is aimed at the protection of consumers.³³⁶ In paragraph 3.4.2 this legislation is discussed in order to determine whether it adequately protects the needs of consumers.

3.4.2 Consumer Protection

The Department of Trade and Industry defines a “consumer” as any natural person to whom any commodity is offered or supplied or made available or from whom any investment is solicited or who supplies³³⁷ or makes available any investment.³³⁸ The department has a number of ongoing initiatives to accomplish its goal of creating a competitive, enabling economic environment that will inspire investors, consumers and business confidence in South African markets, products and services through fair, transparent and effective business regulation. The Consumer and Corporate Regulation Division of the department offers, *inter alia*, the following products and services to consumers: information and advice, inspections, investigations, business compliance; consumer rights protection, brochures and posters; and handling of complaints in terms of the Consumer Affairs (Unfair Business Practices) Act.³³⁹

³³⁶ There is no specific legislation aimed at the protection of suppliers. Suppliers are, however, creditors too. The arguments discussed above relating to the protection of creditors are therefore relevant.

³³⁷ The definition of a “consumer” therefore includes suppliers.

³³⁸ See www.dti.gov.za/protecting_consumers/saconsumerwellbeing.htm (accessed 10 October 2006). This definition is similar to the definition used in the Consumer Affairs (Unfair Business Practices) Act 71 of 1988. A “consumer” is also defined in the National Credit Act 34 of 2005 and the Consumer Protection Bill of 2007, discussed below.

³³⁹ Act 71 of 1988. This Act is discussed below. See www.dti.gov.za/protectingconsumers/saconsumerwellbeing.htm. (accessed 10 April 2007).

The Department of Trade and Industry, through the Consumer and Corporate Regulation Division, also administers legislation that deals with consumer protection. Several of these statutes are discussed in the next section.³⁴⁰

3.4.2.1 Specific Legislation Aimed at Protecting Consumers

a) The Competition Act 89 of 1998, the Consumer Affairs (Unfair Business Practices) Act 71 of 1988 and the Estate Agency Affairs Act 112 of 1976

Consumers are protected in separate statutes. They are, for example, protected in terms of legislation promoting competition and competitive prices. Fair business practices are also regulated. Consumers are also protected in circumstances where abuse is particularly possible, for example, when a consumer buys or sells property through an estate agent. The Competition Act, the Consumer Affairs Act and the Estate Agency Affairs Act are some of the Acts that provide consumers with protection in these areas. It was argued above that the protection of stakeholders in separate legislation should have an effect on a court's decision concerning the existence of directors' fiduciary duties towards these stakeholders. Legislative protection limits the obligation of directors to have fiduciary duties to that specific stakeholder.³⁴¹

The Competition Act³⁴² promotes and maintains competition in order to provide competitive prices and product choices to consumers. The Act also provides for a competition commission that is responsible for the investigation, control and evaluation of restrictive practices, abuse of dominant positions, and for the establishment of a competition tribunal responsible to adjudicate such matters.³⁴³ The purpose of the Act is to provide for an efficient, competitive, economic environment, balancing the interests of workers, owners and consumers in order to provide all

³⁴⁰ See also ch 3 par 3.1.5 on the protection afforded consumers in the United Kingdom.

³⁴¹ See ch 2 par 5.2 above.

³⁴² Act 89 of 1998.

³⁴³ See the Preamble and s 2 of the Competition Act.

South Africans with the opportunity to participate fairly in the national economy.³⁴⁴ It, furthermore, provides for markets in which consumers have access to, and can freely select, the quality and variety of goods and services they desire. It also creates greater capability and an environment for South Africans to compete effectively in international markets.³⁴⁵

The Consumer Affairs (Unfair Business Practices) Act³⁴⁶ protects consumers by providing for the protection and control of certain business practices. A consumer is defined as, *inter alia*, any natural person to whom any commodity is offered, supplied or made available or any natural person from whom any investment is solicited or who supplies or makes available any investment.³⁴⁷ A business practice includes, *inter alia*, any scheme, practice or method of trading, any advertising or any other

³⁴⁴ Section 2 of the Competition Act.

³⁴⁵ See generally on the Competition Act, Reyburn & Sutherland *Competition Law of South Africa* (December 2006).

³⁴⁶ Act 71 of 1988. See Woker “Business Practices and the Consumer Affairs Act” 315–323 where she discusses this Act. She also discusses *Janse van Rensburg NO v Minister of Trade and Industry* 2001 (1) SA 29 (CC) where the constitutionality of the Act was considered. In the High Court the applicants wanted the court to declare the whole Act unconstitutional based on s 22 of the Constitution (right to freedom of trade). The High Court only declared certain sections (ss 7(3) and 8(5)) of the Act unconstitutional. Section 7(3) deals with the right of an investigating officer to enter, inspect and search premises without a search warrant and to seize whatever is found. Section 8 concerns investigations by a committee, a committee can investigate any business practice and if such a practice is considered to be unfair the committee can make a recommendation to the Minister. The Minister can then issue a notice in the *Government Gazette* stating that the business practice is unfair and directing the parties to refrain from practicing it. In terms of s 8(5) the Minister is, however, empowered to act after the notice has been published, but before the committee’s report has been received. The Minister may attach money or property and he or she may prohibit a person from dealing with the money or property. The High Court found that this provision is drastic and does not provide for the *audi alteram partem* principle. The Constitutional Court found that s 8(5) was unconstitutional (s 7(3) had already been amended (stating that a search warrant is necessary) by the Harmful Business Practices Amendment Act 23 of 1999 and the Constitutional Court did not have to decide on it). The Consumer Protection Act will, however, have the effect of repealing this Act.

³⁴⁷ Section 1 of the Consumer Affairs Act 71 of 1988.

manner of soliciting business.³⁴⁸ The Act authorises a committee³⁴⁹ to investigate business practices and to report unfair business practices to the Minister.³⁵⁰

The Estate Agency Affairs Act³⁵¹ protects consumers, especially those who buy or sell property through estate agents. It provides for the establishment of an estate agency affairs board and an estate agents fidelity fund to control certain activities of estate agents that will be in the public interest.

There is also legislation specifically designed for the protection of consumers in the context of the provision of credit and the regulation thereof. The National Credit Act and the Consumer Protection Bill provide extensive protection to consumers and are discussed in more detail below.

b) The National Credit Act 34 of 2005

On 15 March 2006 the National Assembly approved the National Credit Act.³⁵² The Act came into effect on 1 June 2006, but certain sections only came into effect on

³⁴⁸ Section 1 of the Consumer Affairs Act 71 of 1988. This definition is very wide, see Woker “Business Practices and the Consumer Affairs Act” 317–318.

³⁴⁹ The committee is a statutory body and its members are not full-time members. They are appointed on the grounds of having special knowledge or experience of consumer advocacy, economics and law. See s 2(2)(a).

³⁵⁰ See Woker “Business Practices and the Consumer Affairs Act” 316.

³⁵¹ Act 112 of 1976. See generally www.dti.gov.za/protecting_consumers/consumer_rights (accessed 23 June 2007).

³⁵² Act 34 of 2005. In March 2002 the Department of Trade and Industry established a task team to review the legislation that has an impact on consumer credit. In June 2005 the National Credit Bill was tabled by Parliament. See the Policy Framework for consumer credit published by the Department of Trade and Industry, *Consumer Credit Law Reform: Policy Framework for Consumer Credit* 2004 available at <http://www.dti.gov.za/ccrdlawreview/policyjune2005.pdf> (accessed 10 April 2007). See Roestoff & Renke “Debt Relief for Consumers (1)” 561. The National Credit Regulator was established on 1 June 2006 and the National Consumer Tribunal on 1 September 2006. See also www.ngr.org.za (accessed 25 June 2007) – this website explains the National Credit Act and its application in simple terms to the public. The objectives of the Act are listed as well as its key features. The objectives include promoting black economic empowerment and ownership within the consumer credit industry; prohibiting certain unfair credit and credit-marketing practices; and regulating credit information (see the preamble of the Act). Some of the key features of the Act include that the language in credit agreements should be simple, clear and understandable (s 64); quotes must be given on all credit agreements and are binding for 5 days (s 92(3)); automatic increases in credit limits are regulated (s 119) and reckless lending is prohibited (s 80).

1 June 2007.³⁵³ This Act relates to the promotion and advancement of the social and economic welfare of South Africans.

The National Credit Act promotes a fair and non-discriminatory marketplace for access to consumer credit and regulates the provision of consumer credit.³⁵⁴ This Act is aimed at protecting consumers,³⁵⁵ but specifically consumers within the consumer credit industry.

The purpose of the Act is to promote the development of a credit market that is accessible to all South Africans, to ensure consistent treatment of different credit products and different credit providers, to promote responsibility in the credit market by encouraging responsible borrowing, avoidance of over-indebtedness and fulfilment of financial obligations by consumers and to discourage reckless credit granting by credit providers.³⁵⁶ The Act also aims to address the imbalances in negotiating power between consumers and credit providers. A proper balance between these parties will be achieved by educating consumers about credit and

³⁵³ These sections include those on disclosure, limits on interest and fees, reckless lending and all related requirements. See Havenga et al. *Commercial Law* 204–234 on the application of the national Credit Act.

³⁵⁴ On the Act see generally Otto *The National Credit Act Explained*.

³⁵⁵ A “consumer” is defined in the Act as a party to whom goods and services are sold under a discount transaction, incidental credit agreement or instalment agreement. A discount transaction concerns an agreement in terms of which goods or services are provided to a consumer over a period of time and more than one price is quoted for the goods or services, the lower price being applicable if the account is paid on a certain date and a higher price if the account is paid after that date. An “incidental credit agreement” is an agreement in terms of which an account was tendered for goods or services that have been provided to the consumer, or goods or services that are to be provided to the consumer over a period of time where either or both of the following conditions apply: a fee, charge or interest became payable when payment of an amount charged in terms of that account on or before a determined period or two prices were quoted for settlement of the account, the lower price being applicable if the account is paid on or before a determined date and the higher price if the account is not paid by the determined date. An “installment agreement” is a sale of movable property in terms of which all or part of the price is deferred and is to be paid by periodic payments, possession and use of the property is transferred to the consumer, ownership of the property either passes to the consumer only when the agreement is fully complied with or immediately subject to a right of the credit provider to re-possess the property if the consumer fails to satisfy all the consumer’s financial obligation in terms of the agreement, and interest, fees or other charges are payable to the credit provider in respect of the agreement, or the amount that has been deferred.

³⁵⁶ See Roestoff & Renke “Debt Relief for Consumers (1)” 561 regarding the purpose of the Act, namely to protect consumers by addressing and preventing over-indebtedness.

consumer rights, adequate disclosure of standardised information and providing them with protection against unfair fraudulent conduct by credit providers.³⁵⁷

The Act is applicable to all credit agreements between parties, excluding certain juristic persons,³⁵⁸ the State or an organ of the State. An agreement constitutes a credit agreement if it is a credit facility, credit transaction, a credit guarantee or a combination of all three.³⁵⁹

The Act also provides for consumer credit institutions. The National Credit Regulator is an example of such an institution and the Act also provides for a consumer credit industry regulation process.³⁶⁰ A person must be registered as a credit provider, if that person on his own is alone or in conjunction with associated persons the credit provider in respect of at least a hundred credit agreements.³⁶¹

³⁵⁷ Section 3 of the National Credit Act 34 of 2005.

³⁵⁸ Section 8 of the National Credit Act 34 of 2005.

³⁵⁹ An agreement constitutes a credit facility if, in terms of that agreement, the credit provider undertakes to supply goods or services or to pay an amount or amounts, as determined by the consumer from time to time, to the consumer or on behalf of the consumer either to defer the consumer's obligation to pay any part of the cost of goods or services or to repay the credit provider any part of an amount. An agreement constitutes a credit transaction if it is a pawn transaction or discount transaction; an incidental credit agreement, an installment agreement; a mortgage agreement or secured loan; a lease; or any other agreement, other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred, and any charge, fee or interest is payable to the credit provider in respect of, the agreement; or the amount that has been deferred. An agreement constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act applies. See also Roestoff & Renke "Debt Relief for Consumers (1)" 564–569 for the application of the Act.

³⁶⁰ The National Credit Regulator is responsible for regulating the consumer credit industry by registering credit providers. The Regulator must also enforce the Act by promoting informal resolution of disputes between consumers and credit providers arising in terms of the Act, without intervening in or adjudicating such disputes (see ss 14, 15 of the National Credit Act 34 of 2005). It should also monitor the credit market to ensure that prohibited conduct is prevented, investigate that national and provincial registrants comply with the Act, issue and enforce compliance notices and investigate and evaluate alleged contraventions of the Act. The Regulator is also responsible for increasing knowledge of the nature and dynamics of the consumer credit industry and for promoting public awareness of consumer credit matters by implementing, for example, information measures and to provide guidance to the credit market (see s 16 of the National Credit Act 34 of 2005). The National Consumer Tribunal is another body established in terms of this Act (see s 26 of the National Credit Act 34 of 2005). The Tribunal may adjudicate any application that is made in terms of the Act and may make any order provided for in the Act (see ss 26–38 of the National Credit Act 34 of 2005).

³⁶¹ Section 40 of the National Credit Act 34 of 2005. There are a number of exemptions, for example incidental credit agreements are not covered.

Lastly, provision is made for consumer rights in the credit industry, namely the right to apply for credit, protection against discrimination in respect of credit, the right to reasons if credit is refused, the right to information in an official language, the right to receive information in clear and understandable language, the right to receive documents and the right to confidential treatment.³⁶²

c) The Consumer Protection Bill

The Consumer Protection Bill of 2006 was first published in March 2006 for public comment.³⁶³ In December 2007 the third draft of the Consumer Protection Bill was approved by Cabinet.³⁶⁴ The Consumer Protection Bill promotes a fair, accessible and sustainable marketplace for consumer products and services.³⁶⁵ It establishes national norms and standards relating to consumer protection, provides for improved standards of consumer information, prohibits certain unfair business practices and

³⁶² See ss 60–68 of the National Credit Act 34 of 2005. This relates to consumer rights that are especially relevant in the credit industry. The Department of Trade and Industry also lists internationally recognised consumer rights on their website. These rights include the right to satisfaction of basic needs (consumers should have access to basic needs such as food, housing and clothing), the right to safety (consumers should be protected against production processes and products or services that are dangerous to health or life), the right to information, the right to choice (consumers should be able to choose from a range of products), the right to representation (consumers' interests should be represented in the making of government policy), the right to redress (consumers should receive fair settlement of just claims), the right to consumer education and the right to a healthy environment. Most of these rights are also entrenched in the Consumer Protection Bill, which deals with consumers generally and not in a specific industry.

³⁶³ See *Government Gazette* 28629 of 15 March 2006 for the first draft of the Bill. Another draft of the Consumer Protection Bill was issued in September 2006, but not to the general public. It was only issued to those people who commented on the first draft. The Consumer Protection Bill was released for comments soon after the introduction of the National Credit Act. This entails many changes for retail companies. Both Acts will have a significant impact on the cost of doing business. Contracts have to be available in one of the official languages (the supplier can state two official languages in which documents will be made available in); it will be costly and difficult to draft some of the terms and conditions of a contract in some of the official languages. Consumers should also be supplied with various information making the cost of doing business also higher (see clauses 33; 34 of the Bill). See Floor “Consumer Protection Bill” available at www.tradelaw.co.za/news/articles (accessed 10 April 2007).

³⁶⁴ The discussion below is based on the third draft of the Consumer Protection Bill. This Bill emanates from comments received after consulting on the first (of March 2006) and second (of September 2006) drafts. This Bill should be approved by Parliament during May 2008.

³⁶⁵ South African common law relating to consumer rights will be codified in the Bill. The Consumer Protection Bill is applicable to the sale of all goods and services to both individuals and companies. Transactions falling under the National Credit Act are exempted from the Bill as well as transactions concluded with consumers whose turnover exceeds the threshold determined by the Minister by notice in the Gazette. See ss 5; 6 of the Consumer Protection Bill.

promotes responsible consumer behaviour.³⁶⁶ Chapter 2 of the Bill deals with the fundamental consumer rights.³⁶⁷ These rights are similar to the internationally recognised consumer rights advocated by the Department of Trade and Industry. They include the following: the right to equal access to the consumer market,³⁶⁸ the right to privacy,³⁶⁹ the right to choose,³⁷⁰ the right to disclosure and information,³⁷¹ the right to fair and responsible marketing,³⁷² the right to honest and fair dealing,³⁷³ the right to fair, just and reasonable terms and conditions,³⁷⁴ and the right to fair value, good quality and safety.³⁷⁵ Chapter 5 of the Bill deals with consumer protection institutions.³⁷⁶

³⁶⁶ Preamble of the Consumer Protection Bill.

³⁶⁷ A “consumer” is defined as “(a) a person to whom those particular goods or services are marketed in the ordinary course of the supplier’s business; (b) a person who has entered into a transaction with a supplier in the ordinary course of the supplier’s business, unless the transaction is exempt from the application of this Act by section 5(2), or in terms of section 5(3); (c) if the context so requires or permits, a user of those particular goods or a recipient or beneficiary of those particular services, irrespective whether that user, recipient or beneficiary was a party to a transaction concerning the supply of those particular goods or services; and (d) a franchisee in terms of a franchise agreement, to the extent applicable in terms of section 5(6)(b) to (e)”. A “supplier” is defined separately as “a person who markets any goods or services”.

³⁶⁸ This right includes protection against discriminatory market targeting, protection against discrimination in consumer transactions and fair or reasonable grounds for different treatment of consumers. See ss 8–10 of the Consumer Protection Bill.

³⁶⁹ This right includes the right to privacy of personal information and the right to restrict unwanted telephonic access to consumers. See ss 11–12 of the Consumer Protection Bill.

³⁷⁰ This right consists, *inter alia*, of the right to select suppliers and products, authorise services, choose or examine goods, the consumer’s right to acceptance of goods or services and the right to cancel an agreement or transaction. See ss 13–21 of the Consumer Protection Bill.

³⁷¹ This right deals with disclosure of the price of goods or services, product labelling and trade descriptions, the right to information in an official language in plain and understandable language. See ss 22–28 of the Consumer Protection Bill.

³⁷² This right includes the general standards for the promotion of goods and services, customer loyalty programs and promotional competitions. See ss 29–39 of the Consumer Protection Bill.

³⁷³ This right comprises of auctions and the right not to receive false, misleading or deceptive representations. See ss 40–47 of the Consumer Protection Bill.

³⁷⁴ This right deals, *inter alia*, with unfair, unreasonable or unjust contract terms and written consumer contracts. See ss 48–52 of the Consumer Protection Bill.

³⁷⁵ This right includes the general right to fair value, good quality and safety, implied warranty of quality, warranty on repaired goods, duty to notify consumers of defects and the repair or replacement of hazardous goods. See ss 53–61 of the Consumer Protection Bill.

³⁷⁶ See ss 83–98 of the Consumer Protection Bill.

The Bill provides for the establishment of the National Consumer Commission.³⁷⁷ The commission is a mechanism implemented by the Bill which enables consumers to enforce their rights. Thus, it is an alternative to the court system.³⁷⁸ It is a watchdog of consumer protection issues and the first place where complaints can be lodged.³⁷⁹ The members of the National Consumer Commission must have regard to international developments in the field of consumer protection when they carry out their functions. These functions include the monitoring of interests of vulnerable consumers, the investigation and resolution of complaints, the development of codes of practice relating to the Consumer Protection Act, the promotion of legislative reform, the promotion of consumer protection within organs of State, increasing knowledge of the nature and dynamics of the consumer market and promoting public awareness of the consumer market.³⁸⁰

The Bill is a milestone in South Africa's treatment of consumer protection. It will be the first comprehensive legislation codifying the rights of consumers in South Africa. The Bill attempts to codify the common law regarding the rights of consumers and the obligations of those providing services and products to them.³⁸¹

It is clear from this discussion that consumers are protected by various statutory measures. In respect of legislative protection of stakeholders, as stated above,³⁸² it might be better to afford protection to interest groups by way of legislation and not to

³⁷⁷ The Commission is established as an organ of State within the public administration, but as an institution outside the public service. See ss 85–91 of the Consumer Protection Bill.

³⁷⁸ See Floor “Consumer Protection Bill” available at www.tradelaw.co.za/news/articles (accessed 10 April 2007).

³⁷⁹ Mackenzie “Landmark Consumer Protection” available at www.mondaq.com/article (accessed 10 April 2007).

³⁸⁰ See ss 92–98 of the Consumer Protection Bill. See also Mackenzie “Landmark Consumer Protection” available at www.mondaq.com/article (accessed 10 April 2007).

³⁸¹ The aim of this section of the thesis is to indicate that consumers have sufficient protection in other legislation and that it is therefore not necessary to award them with further protection in the Companies Act.

³⁸² See ch 2 par 5.2 above.

broaden the list of beneficiaries of the fiduciary duties of directors. Directors will still be able to consider the interests of consumers when they exercise their fiduciary duties, if it would be in the best interests of the company as a separate legal entity to do so.³⁸³

3.4.3 Supplier Protection

As explained above, the relationship between a company and its suppliers is important for various reasons. From the company's point of view, it is important that suppliers provide a good service to them, with timely deliveries and possible discounts if the company has been using the specific supplier for some time. A company needs to be able to trust and rely on its suppliers. From a supplier's point of view, it would want to be certain of payment and sure that the company does not cancel the contract without a valid reason.

Unlike in the case of consumers, there is no specific statute protecting suppliers. I submit that suppliers are nonetheless sufficiently protected. If a specific supplier is not paid, then he is in a similar position as a creditor and the same rules will be applicable.³⁸⁴

3.4.4 Conclusions

It is clear from the discussion above that consumers (and suppliers as a specific type of creditor) receive adequate protection in other legislation. Consumers receive ample protection in terms of legislation promoting competition and competitive prices.³⁸⁵ Fair business practices are also regulated. The National Credit Act promotes a fair marketplace for access to consumer credit and regulates the provision of consumer credit. The Consumer Protection Bill is the first extensive piece of legislation codifying the rights of consumers.

³⁸³ See generally Havenga "The Company, the Constitution and the Stakeholders" 134–139. See ch 2 par 5.2 above.

³⁸⁴ Paragraph 3.2 above.

³⁸⁵ See the Competition Act 89 of 1998.

Suppliers are also creditors and the rules applicable to creditors are equally applicable to them.³⁸⁶ It was argued in chapter 2³⁸⁷ of this thesis that directors should consider the protection afforded stakeholders in other legislation when determining in whose interests they should manage a company. I suggest that consumers receive extensive protection in other legislation in South Africa, and directors should keep that in mind when managing a company.

3.4.5 The Duty of Care, Skill and Diligence

A director must exercise his duties in good faith and for the benefit of the company. In doing so he must exercise the necessary degree of care and skill. The concept of care and skill received substantial attention in English company law.³⁸⁸ A summary on the extent of a director's care and skill has been provided in *Fisheries Development Corporation of SA Ltd v Jorgensen*, in the light of English decisions.³⁸⁹ It was held that the extent of a director's care and skill depends largely on the nature of the company's business and any specific obligations assumed by, or assigned to, him. A director is not required to have special expertise, but he must exercise the care that can reasonably be expected of a person with his knowledge and experience. A director is not liable for mere errors of judgement.³⁹⁰ A director who does not adhere to this duty of care and skill is liable towards the company in delict for damages.³⁹¹ If there is also a contract between the director and the company he would also be guilty of breach of contract.

³⁸⁶ Paragraph 3.2 above.

³⁸⁷ Chapter 2 par 5.2 above.

³⁸⁸ Chapter 3 par 3.2 above. English case law on the duty of care and skill is relevant when discussing the South African duty of care and skill because South African company law is based on English law. See the following cases on the standard expected of directors when acting with the necessary care and skill: *Re City Equitable Fire Insurance Company Ltd* [1925] 1 Ch 407 (CA); *Re D'Jan of London Ltd* [1994] 1 BCLC 561 (CD). The extent of a director's duty of care and skill depends largely on the nature of the business and any particular obligations assumed by him or assigned to him: *Wolpert v Uitzigt Properties (Pty) Ltd* 1961 (2) SA 257 (W) at 267.

³⁸⁹ *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W).

³⁹⁰ Cilliers & Benade *Corporate Law* 147–148.

³⁹¹ Cilliers & Benade *Corporate Law* 148. See also McLennan "Directors' Duties" 398; Botha "Holding and Subsidiary Companies" 178 and the English case of *Dorchester Finance Co Ltd v Stebbing* (1989) BCLC 498 (Ch).

The Draft Companies Bill of 2007 provides for an objective and subjective test when determining whether a director did act with the necessary care and skill.³⁹² Clause 91(2) also states that a director's judgement that an action is in the best interests of the company is reasonable if the director has taken diligent steps to become informed about the subject matter and does not have a personal financial interest in the subject matter. It should also be a judgement that a reasonable individual in a similar position could hold in comparable circumstances.³⁹³

4 THE STAKEHOLDER DEBATE: APPROACHES FOLLOWED IN THE KING REPORTS, THE POLICY DOCUMENT AND THE COMPANIES BILL OF SOUTH AFRICA

In chapter 2 the enlightened shareholder value and pluralist approaches were discussed and evaluated. The first approach concerns shareholder protection and the second deals with the recognition of stakeholder interests. In this section these approaches are discussed as referred to in the *King Reports*, the *Policy Document* and the Companies Bill of 2007.

4.1 The King Reports

The protection afforded stakeholders and “stakeholder communication”³⁹⁴ were addressed in the *King Reports* and are important for purposes of this thesis. Although *King II* replaced *King I* it is important to refer to the approach on stakeholder protection followed in *King I*. *King II* built on this approach and attempted to clarify the inclusive approach referred to in *King I*.³⁹⁵

³⁹² Clause 91(1)(a)(i) and (ii) of the Bill.

³⁹³ This clause is similar to the business judgment rule applicable in Australia (ch 4 par 3.3). This clause, as drafted in the Bill, is not evaluated in this thesis.

³⁹⁴ Stakeholder communication concerns the provision of relevant information to stakeholders in a clear and understandable manner. This is not the same as stakeholder recognition, which relates to the recognition of stakeholder interests.

³⁹⁵ See *King II* par 29 in the Introduction. See also par 4.3 below.

The *King I Report* explored the concept of different stakeholders and the possibility that the interests of a wider variety of groups should be considered.³⁹⁶ Stakeholders were divided into three categories, namely (1) shareholders, (2) stakeholders with contractual relations with the company and (3) stakeholders with non-contractual relations with the company. Contractual stakeholders include employees, consumers and suppliers; and non-contractual stakeholders include the government and local authorities.³⁹⁷

The importance of communication with stakeholders was also highlighted. Communication with all stakeholders is of the utmost importance to facilitate a good working relationship between them and the company. The *King I* Committee suggested that communications should be open, understandable and transparent, and that the position of the company should be set out in a clear manner. Reporting should include matters such as providing information to employees on staffing, skills, retrenchments and training programmes, environmental issues and social responsibility activities. The following guidelines were provided with regard to the transfer of information to stakeholders: promptness, openness, substance over form, truth and fair participation.³⁹⁸

It is important to distinguish between communication with stakeholders, as discussed above, and the recognition of the different interests of stakeholders by directors when they manage a company. The following is stated in chapter 1 paragraph 3 of *King I*:

Consequently the concept of corporate governance has grown. Other interested parties or stakeholders have become part of corporate governance in the different systems of corporate governance which prevail in different countries. The different stakeholders include shareholders, employees, bankers, suppliers, consumers,

³⁹⁶ *King I* chapters 4, 12, 16.

³⁹⁷ *King I* ch 16.

³⁹⁸ *King I* ch 12 par 17. Thus, in the issuing of any information to shareholders, directors should ask themselves whether the information was transferred in an open and transparent manner, was the communication prompt, relevant and substantial, or was it merely a communication of form and, lastly, did it fairly set out the position?

environmentalists, the community or country in which it operates and the State. One can appreciate that a corporate governance system which attempts to satisfy the needs of each of these differing interest groups would be complex. It must be remembered, however, that it is the primary duty of a board to act honestly in the best interests of the corporation.

Communication with stakeholders is therefore a means of protecting them. It can be seen as recognition of their interests, but it is not the same as acknowledgment of a duty owed to them.

Chapter 1 of *King I* states that the duty of the board is to act honestly in the best interests of the corporation and acknowledging the traditional viewpoint that shareholders should receive primacy when directors manage a company.³⁹⁹ Chapter 5 further maintains that directors must strive to increase shareholder value, while having regard to the interests of all stakeholders.⁴⁰⁰

It therefore seems as if *King I* is in favour of directors managing a company in the best interests of the company, being the shareholders collectively, subject thereto that directors should still have regard to the interests of other stakeholders. Stakeholders should also receive efficient and relevant information from directors concerning the affairs of the company.

King II refers to the acknowledgment of the interests of various stakeholders or the “triple-bottom line” approach.⁴⁰¹ This approach or line of thinking embraces various factors when applied in respect of the management of a company. Social, economic and environmental concerns shape the “triple-bottom line” approach. The economic aspect of this approach concerns financial and non-financial aspects of the business of the company. The environmental aspect relates to the effect on the environment caused by the products or services of the specific company. The social aspect

³⁹⁹ Chapter 1 par 3 of *King I*.

⁴⁰⁰ Chapter 5 par 2.7 of *King I*.

⁴⁰¹ *King II* par 17.1, Introduction; *Executive Summary of King II* par 5.1, 17. See on the “triple-bottom line” Mongalo “The Emergence of Corporate Governance” 177; Shandu “Shareholders’ Interests” 87; Havenga “Regulating Directors’ Duties” 618.

embraces relationships with stakeholders, other than only the company's shareholders.⁴⁰² The shareholders (collectively) are still the most important beneficiary of directors' fiduciary duties, but social, economic and environmental concerns should also be considered. By considering these factors, the shareholders will usually benefit in any event. The concept that the company should be accountable to all legitimate stakeholders is rejected for the simple reason that to ask boards to be accountable to everyone would result in them being accountable to no one.⁴⁰³ The "triple-bottom line" approach is relevant in understanding the enlightened shareholder value approach and specifically its focus on the recognition of stakeholder interests.⁴⁰⁴

King II also refers to the inclusive approach, as mentioned in *King I*.⁴⁰⁵ This approach is linked to the "triple-bottom line" approach and requires that the purpose of the company be defined and its values identified. The relevant stakeholders should be identified.⁴⁰⁶ The inclusive approach further requires that the purpose and values of the company be defined and communicated to all stakeholders. The King Committee confirmed that evidence showed that the inclusive approach is the best way to create business success and long-term growth in shareholder value.⁴⁰⁷

⁴⁰² *King II* par 17.1, Introduction.

⁴⁰³ Mongalo "The Emergence of Corporate Governance" 177; *Executive Summary of King II* par 5.1. See also Mongalo "The Emergence of Corporate Governance" 177, where he refers to *King II*, stating that the board is responsible for relations with stakeholders, but the directors are accountable to the shareholders.

⁴⁰⁴ It is necessary to draw a distinction between "accountability" and "responsibility". The "triple-bottom line" approach is concerned with responsibility. The focus of the enlightened shareholder value approach is on accountability towards shareholders and responsibility towards other stakeholders. See Introduction, par 5.1 of *King II*: "One is liable to render an account when one is accountable and one is liable to be called to account when one is responsible. In governance terms, one is accountable at common law and by statute to the company if a director, and one is *responsible* to the *stakeholders* identified as relevant to the business of the company."

⁴⁰⁵ As discussed above.

⁴⁰⁶ *King II* Introduction, par 6, 35. The inclusive approach can go further than the "triple-bottom line" approach as it can identify stakeholders beyond the social, economic or environmental areas.

⁴⁰⁷ *King II* par 6, 35, Introduction, par 8 of the code.

Although *King I* and *King II* do not specifically refer to their approach on the protection of the interests of stakeholders as the enlightened shareholder value approach, I submit that they do follow it. As stated before, the “triple-bottom line” and inclusive approaches point towards the recognition of different stakeholders, but still see the shareholders as the main beneficiaries of directors’ duties. I therefore submit that *King II* clearly follows the inclusive approach. Shareholders are still the dominant stakeholder, but the report recognises the importance of other stakeholders.⁴⁰⁸ South African commentators⁴⁰⁹ argue that *King I* and *King II* are not sufficiently clear on the preferred approach.

Botha suggests that *King I* created confusion regarding the recognition of stakeholder interests.⁴¹⁰ He argues that the committee failed to state the philosophy with regard to the nature and role of the corporation in South Africa, and that it seems as if there are elements of both the managerialist (or stakeholder) model⁴¹¹ and the contractarian approach⁴¹² in *King I*.⁴¹³

Botha further suggests that references in *King I* to both these approaches or models cause confusion as many references are made to directors acting in the best interests of the “corporation”, which seems to indicate supporting the contractarian

⁴⁰⁸ See pars 4; 5.1 on p 5, pars 5.1; 5.2; 6 on p 6, pars 25–27 on pp 14–15, pars 34–41 on pp 17–19, par 1.2 on p 20, par 2.1.5 on p 21, par 2.6.5 on p 28, par 3.1.4 on pp 30–31, par 3.2.3 on p 32, par 5.1.2 on pp 35–36, par 5.2 on p 37 and par 8 on pp 40–41b of *King II*.

⁴⁰⁹ Botha “Confusion in the King Report” 26–39. See also Spisto “The Significance of the King Reports” 338.

⁴¹⁰ Botha “Confusion in the King Report” 26–39.

⁴¹¹ The managerialist or stakeholder model states that directors do not owe fiduciary duties exclusively to shareholders; there are other groups in addition to shareholders whose interests should also be considered by directors. See Botha “Confusion in the King Report” 24–35.

⁴¹² As stated above, the contractarian approach, on the other hand, states that the essence of the corporation is to maximise shareholder wealth. As discussed in ch 2 par 3 above.

⁴¹³ See also Dine “Company law Developments” 246–251.

approach.⁴¹⁴ Reference is, however, also made to other interest groups and the protection of their interests, indicating that the stakeholder model is preferred.⁴¹⁵

I agree that *King I* may be confusing in the sense that reference is made to “stakeholders” and to “the corporation”. When referring to “stakeholders” and the protection of their interests, the impression is created that *King I* favours the stakeholder model. For example, chapter 1 paragraph 2.4 mentions that the interests of consumers, suppliers and the community are relevant to corporate decision making. The report also refers to the “corporation” and it holds that directors should act in the best interests of the company (or corporation) as a whole, creating the impression that *King I* favours the contractarian approach. Traditionally, “the company” has been interpreted as referring to the shareholders collectively.⁴¹⁶

This is, however, not as confusing as it may seem at first glance and can be explained as follows: the stakeholder model consists of two variants. In terms of the first variant the company is seen as being managed in the interests of shareholders by taking into account other stakeholders. In terms of the second variant it is accepted that interests of other groups must be taken into account because such an approach directly benefits the company.⁴¹⁷ By following the first variant (being similar to the enlightened shareholder value approach), there will be reference to both the “corporation” and to “other stakeholders or interest groups”. The corporation consisting of the shareholders collectively, receives primacy when directors manage a company, but the interests of other stakeholders are also considered. The interests of the consumers, suppliers and the community are therefore relevant in corporate decision making, but this does not imply that shareholders no longer receive primacy. *King I* therefore refers to the “corporation” and that directors should act in the best interests of the company as a whole (being the shareholders collectively), because that is still the

⁴¹⁴ Botha “Confusion in the King Report” 33. *King I* ch1 par 3, ch 5 par 2.1.

⁴¹⁵ See Botha “Confusion in the King Report” 35. *King I* ch 1 pars 2.4; 10, ch 2 par 10, ch 4 par 12, ch 5 par 2.7, ch 13 par 1, ch 20 par 13.2.

⁴¹⁶ See par 2.1.

⁴¹⁷ This is discussed in ch 2 par 3.2 above.

focus of the enlightened shareholder value approach. *King I* also refers to other interest groups as directors should consider their interests too. I therefore submit that *King I* (and subsequently *King II*) favours the enlightened shareholder value approach when indicating that shareholders should receive primacy when directors manage a company, but that other stakeholders should also be considered (as advocated in terms of the “triple-bottom line” and inclusive approaches). It should, however, be noted that *King II* deals with stakeholders in a rather disorderly manner. It is clear, from the above-mentioned discussion, that stakeholders are referred to throughout the report. Stakeholders are not dealt with in a structured manner in one specific paragraph. This way of dealing with stakeholders can create confusion when reading the report and it is easy to miss references to the protection of stakeholders.⁴¹⁸

The *King III Report* is also currently being worked on. It has been indicated that this report will only be issued after the new Companies Act has come into operation. This makes sense, as the two documents should complement each other and not have conflicting provisions.⁴¹⁹

⁴¹⁸ To focus on different issues in various chapters obscure the complete picture. Discussions on the same topics are therefore in different chapters making it difficult to “follow” the golden line. “Stakeholders” are referred to throughout the report and one has to determine the approach preferred by the committee. It is not dealt with in clear terms in a specific chapter or section. In *King II* stakeholders are dealt with in the introduction and in various chapters of section 1. The *King Reports* can be compared with *The Australian Stock Exchange (ASX) Corporate Governance Council’s Principles of Good Governance and Best Practice Recommendations* (March 2003 and August 2007). In this document, one paragraph is devoted to the protection of stakeholders stating in clear terms that directors should also consider the interest of stakeholders when they manage a company (see principle 10 of the March 2003 version and principle 3 of the August 2007 version). This code is discussed in ch par 4.1. Compare also for example the *King II Report* with the *Combined Code* in the United Kingdom (see ch 3 par 4.1 above). It is much easier to determine what the view on the protection of stakeholders (and other governance principles such as the composition of the board) is in terms of the *Combined Code* than *King II*. The *Combined Code* has different sections with a main principle and supporting principles followed by the code provisions.

⁴¹⁹ See Rose “A State of Mind” 31–35 on a possible *King III*. Roy Anderson is the chair of the committee dealing with board and director committees, Anton van Wyk is in charge of the internal audit committee, Suresh Kana heads the accounting and auditing committee, Reuel Khoza deals with sustainability issues, Miranda Feinstein with enforcement issues and David Burdette is the chair of the business rescue committee.

4.2 The Policy Document

The *Policy Document* issued by the Department of Trade and Industry in May 2004, states that company law should promote the competitiveness and development of the South African economy.⁴²⁰

The *Policy Document* deals with the issue of the “scope of company law”, thus the protection of stakeholders, in chapter 3. The drafters refer to the question that every company law reform process usually starts with: “in whose interests should the corporation be run?” They then discuss the history of the debate of stakeholder protection. In terms of the common law, directors are obliged to act honestly in the best interests of the company.⁴²¹ The common law is therefore similar to the enlightened shareholder value approach. The interests of the company have generally been regarded as the interests of the members.⁴²²

The *Policy Document* also discusses the question in whose interests a company should be managed by referring to the enlightened shareholder value and pluralist approaches. The enlightened shareholder value approach is summarised as follows in the *Policy Document*: “[I]n this model directors should have regard, where appropriate, to the need to ensure productive relationships with a range of interested parties – often termed “stakeholders” – and have regard to the longer term, but with shareholders’ interests retaining primacy.”⁴²³ The pluralist approach, asserts that “[c]o-operative and productive relationships will only be optimised where directors are permitted (or required) to balance shareholders’ interests with those of others committed to the company”.⁴²⁴ The document thus confirms that the main aim of the enlightened shareholder value approach is the maximisation of shareholder wealth, whereas the pluralist approach may ignore the interests of shareholders in certain

⁴²⁰ See discussion above. *Policy Document* ch 1 par 2.

⁴²¹ The drafters refer to the English case of *Hutton v West Cork Railway* (1883) 23 ChD 654 (CA).

⁴²² The *Policy Document* ch 3 par 3.2.1.

⁴²³ The *Policy Document* ch 3 par 3.2.2.

⁴²⁴ The *Policy Document* ch 3 par 3.2.2.

instances, in favour of other interest groups. A number of arguments in favour of the enlightened shareholder value approach are mentioned in the *Policy Document*:

- It is the shareholders who invested their capital in the company and they should be entitled to its profits after other claims have been satisfied;
- The shareholders, as residual claimants of whatever is left after all other claims have been paid, are best positioned to police the efficiency of the company;
- The survival and economic success of a company will deliver social benefits to many stakeholder constituencies.⁴²⁵

The *Policy Document* states that “in enhancing economic success of the company (corporate profit and shareholder gain), directors should take account of the policies and principles that are reflected in the Constitution and various kinds of regulation for the benefit of other groups”.⁴²⁶ The *Policy Document* expresses a preference for the enlightened shareholder value approach.⁴²⁷ The *Policy Document* proposes that in the South African context company law should take account of other interest groups, but only in circumstances mandated by the Constitution and related legislation.⁴²⁸

The *Policy Document* suggests the following model:

[A] company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies.⁴²⁹

⁴²⁵ See the *Policy Document* par 3.2.2. These are the arguments advocated by the drafters of the *Policy Document*. See also par 5.1.3 below regarding general arguments for and against exclusive shareholder protection. See further Dean “Stakeholding and Company Law” 66; Miles “Company Stakeholders” 56; Esser “The Protection of Employees” 410.

⁴²⁶ The *Policy Document* par 3.2.2.

⁴²⁷ See also the position of Business of South Africa in the *NEDLAC Report on Corporate Law Reform* (February 2005) (hereafter the *February 2005 NEDLAC Report*) Annexure 2 par 3.2.2 who expresses their preference for the enlightened shareholder value approach.

⁴²⁸ This is in line with the approach taken in *King II*, referred to as the “triple-bottom line” approach.

⁴²⁹ The *Policy Document* at ch 3 par 3.2.3.

This approach could result in a situation where the interests of other groups will have value independent of the interests of the shareholders. For example, the directors may find themselves compelled to provide the employees with certain information as envisaged in their right to access of information as contained in the Constitution⁴³⁰ and in the Promotion of Access to Information Act,⁴³¹ even though doing this might be to the shareholders' detriment.⁴³²

The *Policy Document* concludes that it may be better to deal with the advancement of certain stakeholder interests in separate legislation, subject to the Constitution.⁴³³ If social and environmental changes are incorporated in company law alone, such changes will only affect South African incorporated companies and not overseas companies operating through a South African branch. Companies, as economic agents, have an impact on society and a broader range of stakeholders, but some of these relations are best regulated in separate legislation.⁴³⁴

4.3 The Companies Bill of 2007

Clause 91(1)(b) of the Companies Bill of 2007 is relevant when evaluating which approach to the protection of stakeholders the drafters preferred. It states that a director has a duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests and for the benefit of *the company*.⁴³⁵ The Companies Bill of 2007 provides for a partial codification of directors' duties.⁴³⁶ One of the advantages of such a codification is the clarity that it should provide to

⁴³⁰ Section 32.

⁴³¹ Act 2 of 2000.

⁴³² But see *Clutchco (Pty) Ltd v Davis* 2005 (3) SA 486 (SCA) where it was stated that the shareholders cannot rely on the above-mentioned Act in the specific circumstances. See Esser "The Enlightened-Shareholder-Value Approach" 723; Havenga "Regulating Directors' Duties" 615–617; Locke "Access to a Company's Accounting Records" 222 on the *Clutchco* case.

⁴³³ The *Policy Document* ch 3 par 3.2.3.

⁴³⁴ The *Policy Document* ch 3 par 3.2.3.

⁴³⁵ Emphasis added.

⁴³⁶ See ch 2 of the Companies Bill concerning directors' duties and clause 91(6) stating that the common law is still applicable. See par 5.5 for a discussion of the codification of directors' duties in terms of the Companies Bill.

directors concerning their duties.⁴³⁷ Clause 91(1)(b) has not been drafted in sufficiently clear terms. Firstly, “honestly” and “good faith” are treated as two separate issues. It is unclear as to what the difference is between these two concepts.⁴³⁸ Secondly, the clause provides that directors should act in the best interests and for the benefit of the company. It is not clear what is meant by “benefit”. It is uncertain if this term only relates to a financial benefit or whether any benefit is relevant. By not qualifying “benefit”, it can be argued that it implies that all benefits are relevant when directors manage a company.⁴³⁹ Thirdly, it is unclear what is meant by “the company”. This last aspect is discussed in more detail below.

By stating in clause 91(1)(b) that a director has a duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests and for the benefit of *the company*,⁴⁴⁰ it appears that the drafters of the Companies Bill had opted for the enlightened shareholder value approach. This is, however, by no means clear as will be seen from the discussion below.

The meaning of the “the company” is not clear in terms of the common law and various academics have debated its exact meaning.⁴⁴¹ The Companies Bill created the ideal opportunity to clarify this issue. With the current drafting, it is still unclear whether directors should manage a company for the sole benefit of the shareholders or whether they should consider the interests of other stakeholders. It can be argued that the traditional viewpoint is still applicable due to the wording of the clause (“the company” has always been interpreted as meaning the shareholders collectively) and the *Policy Document* favouring the enlightened shareholder value approach. In

⁴³⁷ See par 5.2 for the advantages and disadvantages of a codification.

⁴³⁸ As indicated by Mervyn King (SC) at the Department of Trade and Industry Conference at Velmore Estate held on 19 and 20 March 2007.

⁴³⁹ These issues were discussed at the Department of Trade and Industry Conference by various speakers.

⁴⁴⁰ Emphasis added.

⁴⁴¹ To name a few South African commentators: Fourie “Die Plig van Direkteure Teenoor Maatskappyskuldeisers” 25–52; Havenga “The Company, the Constitution and the Stakeholders” at 134–139; Mongalo “Self-Regulation versus Statutory Codification” 264–273; Spisto “Stakeholder Interests in Corporate Governance” 129–147. See also Birds et al. *Boyle & Birds’ Company Law* 499; Davies *Gower and Davies’ Principles of Modern Company Law* 371–379; Farrar & Hannigan *Company Law* 380–391 discussing the definition of “a company” in the United Kingdom context.

contrast, it can be argued that the application of the Companies Bill is wider than the traditional position concerning in whose interests directors should manage a company when considering the remedy provisions.

Clauses 163, 164 and 166 in chapter 7, part B of the Companies Bill of 2007 deal with various rights to seek specific remedies. Clause 163 relates to an application to declare a director delinquent or to place a director under probation. A company, a shareholder, director, company secretary or other officer of a company, a registered trade union or other representative of the employees of a company, or the Commission or the Takeover Regulation Panel may apply to a court for an order declaring a person delinquent or under probation. Clause 164 states that a shareholder, *creditor*, or director of a company may apply to a court for relief if directors, *inter alia*, exercised their powers in a manner that is oppressive or unfairly prejudicial to, or unfairly disregards the *interests of the specific applicant*.⁴⁴² Clause 166 relates to derivative actions. A shareholder, former shareholder, a person entitled to be registered as a shareholder, a director, a former director, a registered trade union or another representative of employees may apply to a court on behalf of the company in terms of a derivative action.

It is clear from these provisions that specific parties, who are afforded remedies, have an interest in the management of a company's affairs. The question arises as to whether this changes the traditional common law viewpoint, of directors managing a company in the best interests of the company as a whole, in other words the shareholders collectively.

In clause 164 creditors may apply for relief if their own personal interests are affected by the actions of the directors. This provision therefore provides creditors with a remedy to protect their own interests (as opposed to the interests of the company). This can be interpreted as indicating that directors have fiduciary duties towards creditors, thus changing the traditional common law viewpoint referred to above.

⁴⁴² Emphasis added. See clause 164(1)(c) of the Companies Bill of 2007.

Clauses 163 and 166 may also create confusion as to whom directors owe their duties, although not as directly as is done in terms of clause 164. Clauses 163 and 166 only provide specific parties with certain remedies regarding the interests of the company, whereas clause 164 provides the parties concerned with remedies regarding their own interests.

By defining “the company” this confusion will be eliminated. Should one favour the enlightened shareholder value approach, then the definition of “the company” should state that “the company” refers to the shareholders of the company, with the possibility of including other stakeholders (such as, but not limited to, creditors, employees, consumers, suppliers and the environment), but only when it will be for the purpose of profit maximisation for the shareholders.⁴⁴³ In this way the provision will be in line with the enlightened shareholder value approach and directors will be clear on their duties. In chapter 7 clauses are recommended which should clarify in whose interests directors should manage a company.⁴⁴⁴

4.4 Conclusions

It was argued that the *King Reports* and the *Policy Document* favour the enlightened shareholder value approach, thus advocating for shareholder primacy. The Companies Bill is not sufficiently clear on the approach to follow concerning the protection of stakeholders. A proposed combined theory was recommended in chapter 2.⁴⁴⁵ It was argued that the proposed theory is currently the best way of recognising the various interests of a company, without neglecting the important role of the shareholders or the members as a whole. It cannot be denied that a company is a separate legal entity, represented by several interests, including those of shareholders, employees, investors, consumers, the community and the environment. One therefore cannot require directors only to act in the best interests of the shareholders collectively when acting in “the best interests of the company”. The

⁴⁴³ See s 172 of the United Kingdom’s Companies Act of 2006. This section clearly refers to the interests of different stakeholders. It is therefore clear what is meant by “the company”. See ch 3 par 4.3.3.

⁴⁴⁴ Chapter 7 par 2.6.1.1 below.

⁴⁴⁵ Chapter 2 par 5.2 above.

courts need to give different weight to the degree of interests represented in a company. These interests and the amount of weight attached to them may differ during the various stages of a company. The protection that these stakeholders receive in other legislation may also play a role when a court decides on the competing interests of different stakeholders.⁴⁴⁶

5 CODIFICATION OF DIRECTORS' DUTIES

5.1 Introduction

The section that follows is a discussion of the codification of directors' duties. The *King Reports* are only briefly referred to as they did not deal with the codification of directors' duties in detail. The Companies Bill is discussed in more detail on and provides for a partial codification of directors' duties.

Directors' common law duties are still applicable in terms of a partial codification. In terms of a comprehensive code, courts can still refer to the common law duties when interpreting directors' statutory duties envisaged in the comprehensive code, but they cannot develop new duties. It is therefore argued below, as it was in chapter 4, that the differences between a partial and a comprehensive code are not that significant.⁴⁴⁷

It is important to distinguish between a codification and self-regulation. A code is a "list" of directors' duties entrenched in a statute. These duties are not voluntary; directors have to act in terms of the listed duties. Self-regulatory codes, such as the *King Report*, contain guidelines of best practice and are voluntary. The advantages and disadvantages of a statutory code and a self-regulatory code are discussed below.

⁴⁴⁶ Esser & Du Plessis "Stakeholder Protection" 358. The protection afforded to individual shareholders, creditors, employees and consumers is discussed in par 3 above.

⁴⁴⁷ Chapter 4 par 5 above.

It is important to note that the codification referred to in this discussion concerns a codification of a specific part of company law, this should be distinguished from an “all-embracing” or a “wholesale” codification of civil or common law.⁴⁴⁸

5.2 General Arguments for and Against a Codification of Directors’

Duties

The most obvious argument in favour of a codification of directors’ duties is the fact that it will provide clear and efficient guidelines for directors.⁴⁴⁹ Traditionally, directors’ duties are contained in the common law, case law as well as the Companies Act. A code can save directors much time, effort and money in ascertaining the law and complying with it because it should provide clear guidelines on how directors should act. The main advantage of codifying directors’ duties is that it will enable directors to clearly identify the scope of their duties.⁴⁵⁰

However, to include all relevant duties of directors into one statement can lead to unnecessary brevity. Consider, for example, the duty that a director must exercise his powers for “a proper purpose”. It is unclear what is meant by “a proper purpose” without having knowledge on how the courts have previously interpreted this phrase. It is therefore important that the statutory statement is clear on whether or not one will be able to look back at existing law when interpreting the statement.⁴⁵¹ Directors may also think that the statement is a complete list of their duties, whereas some

⁴⁴⁸ As discussed by Hahlo in “Codifying the Common Law” 23. In this article Hahlo argues against an all-embracing codification of the common law. He indicates specifically that he is not against “law reform by remedial legislation, which will obviously be necessary” (at 23).

⁴⁴⁹ See Goode “The Codification of Commercial Law” 137 where he states that: “Codification fulfils a number of objectives. It simplifies the law and makes it more accessible and more readily ascertainable.”

⁴⁵⁰ See Esser & Coetzee “Codification of Directors’ Duties” 26–31; Birds “The Reform of Directors’ Duties” 154–156 generally. See also Linklater “Codifying Directors’ Duties” 261 where she indicates that research has also shown that directors favour such a statement.

⁴⁵¹ See Havenga “Regulating Directors’ Duties” 620 where she refers to Hannigan *Company Law* who points out that statements are often difficult to interpret without background knowledge as developed by the cases. This was also pointed out by the South African *Policy Document* ch 4 par 4.4.2. See ch 5 par 3.1.2 where the position in New Zealand is considered. New Zealand commentators also state that it should be possible to refer to existing case law when interpreting a statement of directors’ duties.

duties and obligations may be contained in other legislation and regulations.⁴⁵² One of the main disadvantages of codification is therefore the lack of flexibility.

The law is also too complex to be reduced into one statement. Self-regulatory codes (such as the *King Report*) can address the problem of a lack of flexibility. Self-regulatory codes are easier to amend and are more flexible, because they derive from public debate. The main disadvantage of self-regulation relates to its enforcement. Persons who would benefit from the regulating regime would probably also be responsible for regulating it.⁴⁵³ Because of the possible lack of flexibility when codifying directors' duties, both the United Kingdom and New Zealand made it clear that it should be possible to refer to existing case law when interpreting the statement.⁴⁵⁴ The United Kingdom Companies Act of 2006 clearly follows an exhaustive statement of directors' duties, subject to this reliance on existing case law. This exhaustive statement of the United Kingdom Companies Act of 2006 is discussed in detail in chapter 3 above.

Clearly, directors will be more certain of their duties if the duties are codified. Self-regulation provides for flexibility as it can be easily amended. A comprehensive statement or self-regulation is, however, not the only option. The 2007 Companies Bill opted for another option, namely a partial codification of directors' duties where the common law is still applicable.⁴⁵⁵ It is important to state that should one opt for a partial code, then it should be very clear what the relationship is between the code and the common law. It is submitted that the differences between a partial and a comprehensive codification of directors' duties are not necessarily that significant. Judges can still refer to the common law when interpreting directors' statutory duties

⁴⁵² The Department of Trade and Industry in the United Kingdom proposed to give guidance on the statement in "plain language", by distributing authoritative pamphlets. This step would be helpful if the status of the guidance is clear and carefully drafted.

⁴⁵³ Esser & Coetzee "Codification of Directors' Duties" 26–31

⁴⁵⁴ See *Developing the Framework* at pars 3.20; 3.82; *Completing the Structure* at pars 3.2; 3.6; 3.12 and *The White Paper of 2005* at par 3.3 stating that the code is exhaustive in nature and that it will replace the common law; Keay "Section 172(1)" 106–110. See ch 5 pars 3.1.2, 3.1.4 above.

⁴⁵⁵ See par 5.5 below.

in terms of a comprehensive statement.⁴⁵⁶ A comprehensive code is also supposed to be drafted in such a way that it contains all the important common law duties. An exhaustive or comprehensive statement may be a better option compared to a partial one, if courts are allowed to refer to existing principles of case law to interpret the statement. The United Kingdom Companies Act provides for an exhaustive statement and makes it clear that courts should be able to refer to existing case law.⁴⁵⁷

5.3 Codification of Directors' Duties in the King Reports

The King Committee on corporate governance was formed under the auspices of the Institute for Directors in Southern Africa, with support from, *inter alia*, the Johannesburg Stock Exchange⁴⁵⁸ and the South African Chamber for Business. The report was based on the *Cadbury Report* of the United Kingdom, but modified to adopt the specific circumstances of South Africa.⁴⁵⁹ Corporate governance is a very wide topic⁴⁶⁰ and the discussion on the *King Reports* is limited to aspects relevant to directors' duties, especially concerning the codification of their duties.

In 1994 the *King I Report on Corporate Governance* was released. It dealt with a number of corporate governance issues.⁴⁶¹ Its purpose was to create the highest standard of corporate governance in South Africa.⁴⁶² It resulted in a *Code of Corporate Practices and Conduct*, being a set of principles recommended as integral

⁴⁵⁶ Watson "Directors' Duties" at 495–499 also argued this. Du Plessis et al. argue that the statutory duties of directors in Australia are far more important than the duties at common law or in equity, see Du Plessis et al. *Principles of Contemporary Corporate Governance* at 259–260. See also Abernethy & Weir *Anderson's Company & Securities Law* at 8. This argument is also discussed in ch 5 par 3.1.2 when referring to the law of Botswana and New Zealand.

⁴⁵⁷ As discussed in ch 3 par 4.3 above.

⁴⁵⁸ As it then was. It is now the JSE Limited.

⁴⁵⁹ See ch 3 par 4.1 regarding the *Cadbury Report*. See also Armstrong "The King Report on Corporate Governance" 65. The *King Report* also had a wider application than the *Cadbury Report*. The *Cadbury Report* mainly focused on the financial aspects of corporate governance such as financial accounting. *King I* also considered social accounting (including stakeholder protection).

⁴⁶⁰ See Du Plessis et al. *Principles of Contemporary Corporate Governance* 1–3 on the various meanings of "corporate governance".

⁴⁶¹ See generally Armstrong "The King Report on Corporate Governance" 65–70.

⁴⁶² *King II* par 3, Introduction.

to good governance.⁴⁶³ Compliance with the code was, however, voluntary.⁴⁶⁴ The consequences of not complying with *King I* were therefore not as severe as the case in a regulatory system, such as that of the United States.⁴⁶⁵ However, self regulatory codes have indirect consequences such as the negative effect of non-compliance on the reputation of directors and the positive effect that compliance may encourage investment.⁴⁶⁶ The *King Code* applied to all companies listed on the Johannesburg Stock Exchange,⁴⁶⁷ large public entities as defined in the Public Entities Act,⁴⁶⁸ banks, financial and insurance entities as defined in the various Financial Services Acts and large unlisted public companies.⁴⁶⁹

In 2002 the *King Report on Corporate Governance (King II)* replaced *King I*. The review of *King I* was based on four guiding principles. Two of them are directly relevant to this thesis, namely to clarify earlier proposals of an “inclusive” approach and to recommend how compliance with a new code of best practices should be measured.⁴⁷⁰

⁴⁶³ *King I* ch 20.

⁴⁶⁴ Armstrong “The King Report on Corporate Governance” 65; Botha “Confusion in the King Report” 26.

⁴⁶⁵ The Sarbanes-Oxley Act of 2002 of the United States regulates certain aspects of corporate governance and is not based on self-regulation. The Act deals with the following issues: The public company accounting oversight board, auditor independence, corporate responsibility, enhanced financial disclosures, conflicts of interest, commission resources and authority, corporate and criminal fraud accountability, white-collar crime penalty enhancements, corporate tax returns, corporate fraud and accountability. See generally on the Act: <http://www.sarbanes-oxley.com/> (accessed 25 January 2008).

⁴⁶⁶ In Australia James Hardie Ltd, a large product manufacturer, was subject to a special commission of inquiry in 2004 concerning personal injury due to asbestos related injuries. The asbestos settlement that was reached is a good example of the importance of complying with good corporate governance practices and specifically stakeholders’ interests. In this case a company was not able to support medical claims of employees who suffered due to previous operations of the company. Eventually the company did create a fund for these victims based on pressure from politicians, the government and even the shareholders. See Du Plessis et al. *Principles of Contemporary Corporate Governance* 47 for a discussion of this case.

⁴⁶⁷ Now the JSE Ltd.

⁴⁶⁸ Act 93 of 1992.

⁴⁶⁹ *King I* ch 20 par 1.1.

⁴⁷⁰ The other two principles were: to assess the validity of *King I* against developments, locally and internationally and to recognise the importance placed on non-financial issues and to recommend reporting on issues associated with social and ethical accounting, auditing and safety, health and

King II mainly deals with principles of good governance relating to boards and directors,⁴⁷¹ risk management,⁴⁷² internal audits,⁴⁷³ integrated sustainability reporting⁴⁷⁴, accounting and enforcement.⁴⁷⁵ The essential corporate governance principles identified in *King II* are discipline, transparency, independence, accountability, responsibility, fairness and social responsibility.⁴⁷⁶ The report also contains a *Code of Corporate Practices and Conduct*, which replaced the Code incorporated in *King I*.⁴⁷⁷ Compliance with *King II* is voluntary and the principles in *King II* are based on a “comply or explain” basis.⁴⁷⁸ It is not always clear whether all principles contained in the *King Report* should be explained, if not complied with, or whether some “principles” in *King II* are merely suggestions or expectations that companies should strive to meet.⁴⁷⁹ The underlying principle of *King II* is that directors should act not only in accordance with the letter of the law, but also in the spirit of their fiduciary duties.⁴⁸⁰

environmental issues; *King II* par 29 in the Introduction; *Executive Summary of King II* par 29. See par 4.2 relating to the “inclusive” approach.

⁴⁷¹ See pp 21–30 of the code and pp 46–76 of *King II*.

⁴⁷² See pp 30–31 of the code and pp 76–90 of *King II*.

⁴⁷³ See pp 34–35 of the code and pp 90–96 of *King II*.

⁴⁷⁴ See pp 35–38 of the code and pp 96–133 of *King II*. See pp 38–40 of the Code and pp 133–153 of *King II*.

⁴⁷⁵ See pp 38–41 of the code and pp 153–171 of *King II*. See ss 1–6 of *King II*.

⁴⁷⁶ See pp 10–11 of *King II*.

⁴⁷⁷ See pp 20–41 in *King II*. See also Loubser “Does the King II Report Solve Anything?” For the application of the code see par 1 of the *Code of Corporate Practices and Conduct* in *King II*.

⁴⁷⁸ See, for example, the values, visions and profile of JD Group Pty Ltd at www.jdgroup.co.za/2007/corporate_governance.htm (accessed 17 August 2007). It is stated that the company complied with *King II*, except for the requirement that the chair should be a non-executive director. The reason for this is then explained in the report.

⁴⁷⁹ In terms of par 8.4 p 41 of *King II* a company has to explain if it did not comply with the code. It can therefore be argued that everything in the code should be interpreted as “comply or explain” provisions. It is uncertain whether provisions in *King* which are not contained in the code itself also resort under “comply or explain” provisions. The latter may only be suggestions to enhance good corporate governance.

⁴⁸⁰ Esser & Coetzee “Codification of Directors’ Duties” 27.

King I did not deal with the codification of directors' duties in detail. In chapter 5 of *King I* a list of directors' duties is provided. These duties include that directors should remain knowledgeable about the financial, social and political milieu in which a company operates, they must never permit a conflict of interests, must act independently, and with care and skill when exercising their duties with the utmost good faith. It must be noted that the list is not exhaustive and the committee does not support a statutory manual of directors' duties.

King II does not deal with the issue of a possible codification of directors' duties. The report focuses more on good corporate governance principles and is important for purposes of this thesis due to its emphasis on the inclusive approach, as discussed in paragraph 2.2.2 above.

5.4 Codification of Directors' Duties in the Policy Document

The codification of directors' duties was considered in the *Policy Document* in more detail compared to the *King Report*.⁴⁸¹ It confirms that the regulation of directors' duties is a very difficult issue. In South Africa most of the duties of directors are found in the common law and case law, and research shows that directors are not clear about their duties.⁴⁸²

A statutory standard can assist in providing clarity in respect of directors' duties. However, the advantages of a statutory statement need to be evaluated against the constraints that it can place on the development of common law.⁴⁸³ The *Policy Document* prefers a statutory statement of directors' duties. It is argued that a statutory statement will provide clarity, making the law more accessible for directors and ensuring that they are clear about their duties and obligations. Foreign and domestic investors will also have more clarity on the rules that govern the behaviour of directors and the remedies that are available should these rules be violated.⁴⁸⁴

⁴⁸¹ The *Policy Document* ch 4 par 4.4.2.

⁴⁸² Paragraph 1 above and the *Policy Document* ch 4 par 4.4.2.

⁴⁸³ The *Policy Document* ch 4 par 4.4.2.

⁴⁸⁴ Havenga "Regulating Directors' Duties" 619.

5.5 Codification of Directors' Duties in the Companies Bill

Chapter 4 of the 2007 Bill addresses issues relating to corporate governance.⁴⁸⁵ The aim of the provisions in chapter 4 is to enhance transparency and accountability.⁴⁸⁶ Part B of chapter 4 introduces a new law in the form of a codified regime of directors' duties, which includes both a fiduciary duty and a duty of care, skill and diligence. This codification is intended to operate in addition to existing common law duties.⁴⁸⁷ The Companies Bill of 2007, especially clauses 91–94, therefore provides for a partial codification of directors' duties, as discussed above.

Clause 91 governing directors' duties of good faith and care, skill and diligence are supplemented by new provisions (in clauses 92–94) addressing conflict of interests, directors' liability, indemnities and insurance.⁴⁸⁸ Clause 92 deals with a director's use of information and conflicting interests. A director must not, directly or indirectly, use his position as director to make a secret profit or otherwise gain an advantage for himself or for someone else. He may also not use his position to cause detriment to the company. He must also not use any information that he obtained due to his position as a director improperly by gaining an advantage for himself or someone else, or by causing detriment to the company. If a director has a financial conflicting interest concerning a matter that will be voted on at a meeting, then he should declare that interest, leave the meeting and not take part in any discussion relating to that specific matter. Clause 93 relates to loans and other financial assistance to directors. A company may not provide a loan to, secure a debt or obligation for, or otherwise provide direct or indirect financial assistance to, a director or a director of an interrelated company unless certain conditions are present. These conditions include that the company's Memorandum of Incorporation must expressly permit the giving

⁴⁸⁵ Clause 84 deals with the board of directors, clause 85 with board meetings, clause 86 with directors acting other than at a meeting, clause 87 with board committees, clause 88 with the election and removal of directors, clause 89 with disqualified persons who may not act as directors and clause 90 with vacancies on the board.

⁴⁸⁶ Especially relating to the manner and form of shareholder meetings, the exercise of proxy rights and the standards for adoption of ordinary and special resolutions (see p 13 of the *Explanatory Memorandum*). These provisions are not discussed in detail in this thesis.

⁴⁸⁷ Clause 91(6) of the Bill and p 13 of the *Explanatory Memorandum*.

⁴⁸⁸ Clause 91(1)(b) is of specific importance and was discussed in par 4.3 above.

of financial assistance, the company should comply with the solvency and liquidity tests, and the terms of the finance agreement should be fair and reasonable. Clause 94 deals with the liability of directors and officers, and states that any provision in a Memorandum of Incorporation is void if it directly or indirectly relieves a director of liability. The remaining part of chapter 4 largely retains existing law regarding financial records and statements, auditors, audit communication and company secretaries.⁴⁸⁹

The codification of directors' duties (or the statement of directors' duties) is welcomed because directors will be clearer on what their duties are. The common law will, however, still be applicable and will ensure that directors' duties are still flexible and capable of development. When opting for a partial code it is, however, important that the relationship between the statutory duties and the common law be clear. I submit that this is currently not the case in terms of the Companies Bill. It was also argued in chapter 3 that an exhaustive code is not necessarily problematic as courts will still be able to refer to existing case law when interpreting the code. In the end, it is more important to have a code of directors' duties, as this will make the law more assessable for directors. Whether the code is partial or comprehensive is not that important, as argued before.

6 CONCLUSIONS

In this chapter an attempt was made to determine in whose interests directors should manage a company. It was stated that the traditional viewpoint is that a company should be managed in the best interests of the shareholders collectively.⁴⁹⁰ The protection of different stakeholders is, however, important when directors manage a company.⁴⁹¹ This chapter focused on the primary stakeholders,⁴⁹² namely individual

⁴⁸⁹ See parts C, D and E of ch 4 of the Bill

⁴⁹⁰ Paragraph 2.1.1.

⁴⁹¹ This is referred to as the "triple-bottom line" or "inclusive" approach by *King II*.

⁴⁹² Paragraph 3 above.

shareholders, creditors, employees, consumers and suppliers. The legislative protection currently afforded them in South African law was discussed and evaluated.

Directors may find themselves liable to shareholders individually under ordinary principles of law, but they do not owe fiduciary duties to them directly.⁴⁹³ With regard to employees, different means of protection were explored to determine whether they are adequately protected or not.⁴⁹⁴ If they do not receive adequate protection elsewhere, it was argued that directors should consider their interests when they manage a company.⁴⁹⁵ It was also argued that worker participation on board level does not seem to be the preferred route in South Africa. The conclusion was drawn that worker participation will not work in a unitary board structure, even if the unitary board structure has similarities to the two-tier board structure, as is the case in South Africa.⁴⁹⁶ The fact that employees are not the only other interest group is another reason not to have worker participation at board level. It will be impractical to provide consumers, suppliers and the general public with board representation and there is no good reason why employees should receive preference in this regard. There are other options available to enable worker participation. Workplace forums are one option,⁴⁹⁷ although these forums are currently not widely implemented in South Africa.⁴⁹⁸ Collective bargaining⁴⁹⁹ is also an option for trade unions as management can discuss issues that are important to employees. Admittedly collective bargaining has shortcomings, but it provides a platform for employees to voice their concerns through their trade union representatives with regard to their terms and conditions of employment. Directors can also be employees. This is usually the case with managing directors. Should there be a conflict of interests between the director's interests as an employee and the interests of the company, the

⁴⁹³ Paragraph 3.1.

⁴⁹⁴ Paragraph 3.3 above.

⁴⁹⁵ Chapter 2 par 5.2 above.

⁴⁹⁶ Paragraph 3.3.2.1 above.

⁴⁹⁷ Section 79 of the Labour Relations Act.

⁴⁹⁸ Paragraph 3.3.2.2 above.

⁴⁹⁹ Section 213 of the Labour Relations Act.

specific director should abstain from voting. Employees therefore enjoy various other forms of protection in labour legislation in South Africa.

The position of creditors was also considered. Arguments were raised for and against a direct duty owed by directors to creditors. The majority of cases indicated that this duty towards creditors should be an indirect one.⁵⁰⁰ Because of the shortcomings in the protection currently afforded creditors, mainly the problems associated with section 424 of the Companies Act of 1973 and contractual protection, it is submitted that directors should have fiduciary duties to creditors in certain instances.⁵⁰¹ The interests of creditors would, therefore, sometimes receive preferential treatment. The rationale for this lies in the fact that the company is effectively trading with the creditors' money when it is in financial distress.⁵⁰² Case law does not provide clear guidelines as to when such a duty would arise. Keay suggests an objective test, stating that the best trigger would be that the circumstances of a specific company indicate that a director could reasonably be able to expect that his or her actions could lead to insolvency of the company.⁵⁰³ I agree that this is the best option to determine when directors should consider the interests of creditors. I therefore submit that directors should consider the interests of creditors in certain instances, even if this consideration can be to the detriment of the shareholders. These instances include when a company is in financial difficulty.⁵⁰⁴

Consumers are also protected in other legislation. They receive protection in different areas, such as in cases of the provision of credit or when a consumer buys or sells a house through an estate agent. The new Consumer Protection Bill provides protection in a wide variety of instances.⁵⁰⁵

⁵⁰⁰ Paragraph 3.2 above.

⁵⁰¹ Paragraph 3.2 above.

⁵⁰² Paragraph 3.2 above.

⁵⁰³ Paragraph 3.2.2 above.

⁵⁰⁴ Paragraph 3.2 above.

⁵⁰⁵ Paragraph 3.4.2 above.

In view of the theory proposed in chapter 2, directors need to be aware of the protection that these stakeholders receive elsewhere in order to know when and to what extent to consider their interests when they manage a company. It is proposed that companies should issue guidelines to directors indicating what type of protection these stakeholders receive in other legislation. In this way it will be clearer to directors when to consider which stakeholder.⁵⁰⁶ It was argued that the *King Reports* and the *Policy Document* prefer the enlightened shareholder value approach. The Companies Bill is, however, unclear on its approach concerning stakeholder protection.⁵⁰⁷

⁵⁰⁶ Chapter 2 par 5.2 above.

⁵⁰⁷ Paragraph 4.3 above.

CHAPTER 7

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

1 REVIEW OF RESEARCH CONDUCTED

2 FINDINGS AND CONCLUSIONS

1 REVIEW OF RESEARCH CONDUCTED

This thesis investigated in whose interests directors should manage a company. The focus was on directors' duties and specifically the duty to manage a company in good faith and in the best interests of the company as a whole. This duty of directors was discussed and evaluated as applied in South Africa, Botswana, Australia, New Zealand and the United Kingdom. The codification of directors' duties was also considered as a means to provide directors with clarity on their duties.¹

At the outset it was stated that various questions arose. Firstly, it had to be determined whether companies should be managed for the benefit of only the shareholders, or whether a wider variety of stakeholders had to be considered. Secondly, the extent to which companies should advance broader social goals had to be considered. The final issue was whether any such obligation to consider the interests of other stakeholders had to be enforceable by the stakeholders against the directors.

In order to answer these questions the following matters were addressed.

In chapter 2 a theoretical foundation was provided concerning shareholder primacy and the more current development to consider the interests of other stakeholders, such as employees, creditors and consumers. The various theories of corporate governance and the models based on the theories were considered. The Berle–Dodd debate on the role of directors in a corporation and specifically for whose benefit directors should

¹ Chapter 3 par 4.3.4; ch 4 par 5; ch 6 par 5.

manage a company was referred to.² Three main theories on the nature of a company were considered.³ It was indicated that any specific theory usually has a shareholder or stakeholder emphasis. A combined theory was proposed recommending whose interests directors should consider when they manage a company.⁴

Chapters 3, 4 and 5 provided an international comparative survey. In chapter 3 the position in the United Kingdom was considered. The main reason for considering this jurisdiction is that South African company law is largely based on the English system. Furthermore, the recent review of company law in the United Kingdom may provide useful guidelines for the South African company law review.⁵ The protection currently afforded individual shareholders, creditors, employees and consumers in the United Kingdom was discussed.⁶ Corporate governance codes, the consultation documents issued during the United Kingdom company law review by the Steering Group and the Companies Act of 2006 were also considered in order to determine the viewpoints of the drafters on the protection of stakeholders and the codification of directors' duties.⁷

In chapter 4 the position in Australia was discussed. The company laws in Australia are based on English law. But, similar to South Africa, Australia deviated from English law after Australia's company law reviews. It is therefore important to consider Australian company law and its corporate governance initiatives to determine whether South Africa can benefit from developments in Australia. Protection granted to shareholders, creditors, employees and consumers was

² Chapter 2 par 2.

³ Chapter 2 par 3.

⁴ Chapter 2 par 5.2.

⁵ Chapter 1 par 4.

⁶ Chapter 3 pars 3.1.2–3.1.6.

⁷ Chapter 3 par 4.

considered⁸ and corporate governance documents issued in Australia were evaluated, focusing on their viewpoints on stakeholder protection.⁹

In chapter 5 the law of Botswana was discussed. It was indicated that it is especially meaningful to consider another African and SADC country with circumstances similar to those in South Africa. The new Botswana Companies Act of 2003 was considered with the view to determining whether Botswana went against SADC's goal of harmonisation of business laws in southern African states by adopting New Zealand company law instead of English law.¹⁰

Chapter 6 dealt with the position in South Africa. A brief overview was provided on the fiduciary duties of directors and specifically the duty to act in good faith to the benefit of the company.¹¹ The traditional interpretation of a director's duty to act in good faith in the best interests of the company was discussed.

The protection currently afforded individual shareholders, creditors, employees and consumers was evaluated.¹² It was considered important to determine whether these stakeholders receive adequate protection elsewhere, other than in company legislation, as this would determine the role that company law should play in protecting these stakeholders. The current company law review process was also considered focusing on stakeholder protection and the codification of directors' duties. The recommendations in the two *King Reports* on corporate governance of 1994 and 2002, the *Policy Document* and the Draft Companies Bill of 2007 were considered in this regard.¹³

⁸ Chapter 4 pars 3.2.2–3.2.6.

⁹ Chapter 4 par 4.

¹⁰ Chapter 5 par 3.1.3.

¹¹ Chapter 6 par 2.1.

¹² Chapter 6 par 3.

¹³ Chapter 6 pars 4; 5.

2 FINDINGS AND CONCLUSIONS

2.1 A Theoretical Foundation

In chapter 2, a foundation was provided on the theories of a company. The theories on the nature of a company derive from the origin and purpose of corporations. A theory usually emphasises a shareholder or stakeholder approach. The agency, *communautaire* and concession theories were discussed.¹⁴

The agency or contractual theory focuses on shareholder primacy. In terms of this theory, the company is seen as a “*nexus* of contracts”.¹⁵ The corporation is seen as a constantly re-negotiated contract where each party wants to maximise his own utility.¹⁶ The *communautaire* and concession theories focus on the role of the State as well as the recognition of different stakeholders. In terms of the concession theory, a corporation’s existence and operation is a concession of the State in granting the ability to use this corporate tool.¹⁷ The *communautaire* theory regards the company as an instrument (and not a mere concession) of the State.¹⁸ Both these theories have a strong social dimension, emphasising that directors should consider the interests of stakeholders when they manage a company.¹⁹

In recent company law review processes in South Africa and the United Kingdom drafters referred mainly to two theories when attempting to determine in whose interests directors should manage a company, namely the enlightened shareholder value approach and the pluralist approach.²⁰ In the enlightened shareholder value approach the primary role of the directors is seen as promoting the success of the

¹⁴ Chapter 2 par 3. As discussed in this chapter there are many theories. I focused on only the most generally accepted ones.

¹⁵ Chapter 2 par 3.1.

¹⁶ Chapter 2 par 3.1.

¹⁷ Chapter 2 par 3.2.

¹⁸ Chapter 2 par 3.3.

¹⁹ Chapter 2 par 3.

²⁰ Chapter 2 par 5.1.

company for the benefit of the company as a whole and generating maximum value for shareholders. This conclusion is based on the “too many masters” argument; namely if more stakeholders were recognised in whose favour the duties of directors had to be exercised, the various stakeholder groups would have to be identified and the nature and the extent of directors’ duties and responsibilities to each of them would need to be determined.²¹ The result would be that directors would not effectively be held accountable to anyone, since there would be no clear yardstick for judging their actions. The second school is that of pluralism, which sees shareholders as one constituency among many and recognises the interests of various groups. Thus, a company’s existence and success are seen as inextricably intertwined with the consideration of the interests of its employees and other potentially qualifying stakeholders in the business, such as suppliers and customers.²² It is important to note that these two approaches are not the only relevant ones. The difference in emphasis (focusing on shareholder primacy or stakeholder protection) in the two approaches underlies all theories on the nature of a company.²³

2.2 Recommendation: A Proposed Combined Theory

Arguments for and against the traditional position where shareholders receive primacy when directors manage a company were discussed. Because of the shortcomings in the arguments relating to exclusive shareholder protection, a combined theory was proposed in chapter 2 as a possible way forward in recognising the interests of stakeholders without disregarding shareholders’ interests. The starting point of the proposed theory is a very fundamental one: directors owe their duties to the company and only to the company, as a separate legal entity. A company is represented by several interests, including those of shareholders, employees and creditors. It was argued that to require directors to act in good faith in the interests “of the company”, cannot nowadays mean anything else but that a blend of all these interests would have to be considered. Directors should first and foremost act in the best interests of the company as a separate legal entity. An interest that may be

²¹ Chapter 2 par 5.1.

²² Chapter 2 par 5.1.

²³ Chapter 2 par 5.1.

primary at one point in a company's existence may become secondary at a later stage. This continuing process was compared to a merry-go-round. Different weights need to be attached to the various interests represented in a company at various times. These interests and the importance attached to them may differ during the various stages of a company's existence. The protection that different stakeholders receive by means other than company law plays an important role when determining how much weight to attach to the different interests.²⁴ It was, furthermore, suggested that directors should be aware of the protection afforded stakeholders in order to know how to balance the competing interests of stakeholders. Codes of best practice may be a possible way to achieve this and to ensure that directors are informed about the protection that stakeholders receive in other legislation.²⁵

2.3 The Law in the United Kingdom

United Kingdom company law was considered with reference to two issues, namely the protection of stakeholders and the codification of directors' duties. The traditional viewpoint provides shareholders collectively with primacy in both the United Kingdom and South Africa when directors manage a company.²⁶ The stakeholder debate was influential in the company law reform processes in both the United Kingdom and South Africa. Both countries opted for the enlightened shareholder value approach indicating that shareholders should receive primacy when directors manage a company, but that other stakeholders should also be considered when the consideration of their interests will promote profit maximisation for the shareholders.²⁷ Other stakeholders should, obviously, also be considered when company management is mandated to do so in terms of specific legislation, even if such consideration will not necessarily maximise profits for the shareholders. It is interesting to note that the United Kingdom and South Africa dealt with the issue of stakeholder protection differently. Section 172(1) of the United Kingdom Companies

²⁴ This is why the protection afforded individual shareholders, creditors, employees and consumers was discussed in the different chapters.

²⁵ See ch 2 par 5.2 and Esser & Du Plessis "Stakeholder Protection" 358.

²⁶ Chapter 3 par 3.1.1.

²⁷ Chapter 3 par 4.3.3 and ch 6 par 4.2.

Act of 2006 specifically provides that directors should consider stakeholders' interests when managing a company.²⁸ However, no remedies are provided to assist stakeholders with the enforcement of the rights given to them in section 172(1). But in South Africa no specific reference is made to stakeholders in clause 91(1)(b) of the Draft Companies Bill of 2007, but remedies are provided to certain stakeholders in specific circumstances.²⁹

2.3.1 Stakeholder Protection and the Codification of Directors' Duties

Various corporate governance codes, the consultation documents of the company law reform committees, the Companies Bill of 2006 and the Companies Act of 2006 were considered to determine the viewpoints of the drafters and committees on stakeholder protection.³⁰ The codification of directors' duties entrenched in the Companies Act was also considered.³¹

It was found that the *Cadbury* and *Greenbury Reports* did not specifically deal with the issues of stakeholder protection and in whose interests directors should manage a company.³² The committees equated a company's interests with those of its shareholders and they based their recommendations on this viewpoint.³³ They therefore favoured the traditional viewpoint. The *Hampel Report* is also in favour of directors managing a company in the best interests of the shareholders collectively with reference to the interests of other stakeholders.³⁴ The Steering Group distinguished between the enlightened shareholder value and pluralist approaches during the company law review process. Various consultation documents published during the review process such as the *Strategic Framework*, *Developing the Framework* and *Completing the Framework* as well as the *White Papers* were

²⁸ Chapter 3 par 4.3.3.

²⁹ Chapter 6 par 4.3

³⁰ Chapter 3 par 4.2.3; 4.3.3.

³¹ Chapter 3 par 4.3.4.

³² Chapter 3 par 4.1.

³³ Chapter 3 par 4.1.2.

³⁴ Chapter 3 par 4.1.2.

evaluated. It was concluded that the drafters of these documents followed the enlightened shareholder value approach.³⁵ The Companies Act of 2006, following the recommendations of the Steering Group, also prefers the enlightened shareholder value approach and states, in section 172(1), that directors should consider the interests of stakeholders when they manage a company. Shareholder primacy was therefore maintained.³⁶ It was, however, argued that it is unclear how this provision will operate in practice as no guidelines are provided in the Act on how directors should balance the interests of different stakeholders.³⁷

With regard to the codification of directors' duties, it was noted that the Companies Act of 2006 contains an exhaustive code of directors' duties. This was also recommended by the Steering Group during the company law review process. It was argued that the word "exhaustive" does not preclude courts from referring to existing case law when developing directors' duties, but that they cannot develop new duties.³⁸

2.3.2 Protection Afforded Stakeholders

The protection afforded individual shareholders, creditors, employees and creditors was considered.³⁹ It was indicated that it is important to be aware of the protection that stakeholders receive in other legislation as this should influence directors' decisions to consider stakeholders' interests when they manage a company.⁴⁰

The consideration of case law indicated that in the absence of a special relationship, directors will not have fiduciary duties towards individual shareholders.⁴¹

³⁵ Chapter 3 par 4.2.3.

³⁶ Chapter 3 par 4.3.3.2.

³⁷ Chapter 3 par 4.3.3.

³⁸ Chapter 3 par 4.3.4.

³⁹ Chapter 3 par 3.1.1.1.

⁴⁰ Chapter 2 par 5.2.

⁴¹ Chapter 3 par 3.1.2.

It was concluded that directors do not have a general fiduciary duty to consider the interests of creditors.⁴² This issue was discussed in detail during the company law reform process. It was argued that directors should not act in the best interests of creditors. It was specifically concluded that creditors should not be included as stakeholders to whom directors should have regard when managing a company. This was mainly based on the fact that creditors receive sufficient protection in section 214 of the Insolvency Act of 1986. Case law dealing with the protection of creditors was also considered. It was concluded that directors should consider the interests of directors in cases of doubtful solvency.⁴³

Employees are protected in various statutes in the United Kingdom.⁴⁴ Collective consultation between employers and their employees through recognised trade unions or elected employee representatives is required in a number of specific situations.⁴⁵ These consultation obligations have steadily been expanded over recent years and have been entrenched in various regulations like the Transnational Information and Consultation of Employees Regulations of 1999, the Information and Consultation of Employees Regulations of 2004 and the Occupational and Personal Pension Schemes (Consultation by Employees and Miscellaneous Amendments) Regulations of 2006.⁴⁶

Consumers generally receive extensive protection.⁴⁷ Specific legislation⁴⁸ (and websites and public bodies)⁴⁹ provide general protection to consumers in the retail

⁴² Chapter 3 par 3.1.3.

⁴³ Chapter 3 par 3.1.3.

⁴⁴ Chapter 3 par 3.1.4.

⁴⁵ For example, the Transfer of Undertakings (Protection of Employment) Regulations 2006 SI 2006/246 regulations 13 – 15, facilitated further by the Employment Relations Act 1999 s 1.

⁴⁶ Chapter 3 par 3.1.4.

⁴⁷ Chapter 3 par 3.1.5.

⁴⁸ For example, the Enterprise Act of 2002 and the Consumer Credit Act of 2006.

⁴⁹ For example, the Office of Fair Trading, a non-ministerial department established in terms of the Fair Trading Act of 1973 (see www.offt.gov.uk). At www.consumerdirect.gov.uk consumers receive advice on their rights concerning guarantees, buying on credit, refunding or cancelling of orders, dealing in disputes and unfair clauses in contracts. This website is a government-funded telephone and online service for consumers. At www.tradingstandards.gov.uk consumers are also advised on their

markets. The laws of competition and credit protection also provide consumers with protection.⁵⁰

2.4 Australian Law

Australian company law was considered in chapter 4. First, a brief overview was provided on the general and statutory duties of directors. Australia has partially codified directors' duties in the Corporations Act of 2001.⁵¹ It was, however, indicated that the statutory duties are of much more practical importance compared with the general duties in Australia since parties usually rely on a statutory and not a general duty in litigation.⁵² This is mainly due to the fact that the code is drafted in clear terms and is based on the common law. It was found that the differences between these two types of codes are not necessarily significant because judges may still refer to case law when interpreting the duties of directors in terms of a comprehensive code.

2.4.1 Stakeholder Protection and the Codification of Directors' Duties

With regard to the protection of stakeholders it was found that the traditional position in Australia is that directors should act in the best interests of the shareholders collectively.⁵³ But a number of corporate governance initiatives in Australia indicate that the enlightened shareholder value approach (or business approach or enlightened self-interest approach) should be followed.⁵⁴ Directors should also consider the interests of other stakeholders when they manage a company. Stakeholders are, however, not directly referred to in the Act as in the United Kingdom. The protection of stakeholders' interests is self-regulatory and based on voluntary corporate governance initiatives.⁵⁵ Some reports suggested alternative methods on how to

position in the United Kingdom. This website is supported by the Trading Standards Institute. See Keenan & Riches *Business Law* 416–417.

⁵⁰ Chapter 3 par 3.1.5.

⁵¹ Chapter 4 par 1.

⁵² Chapter 4 par 5.

⁵³ Chapter 4 par 3.2.1.

⁵⁴ Chapter 4 par 4.

consider the interests of other stakeholders, including the suggestion that the remuneration of directors should be linked to corporate responsibility.⁵⁶

2.4.2 Protection Afforded Stakeholders

Other means of protecting the interests of employees, consumers and creditors were also considered. Directors do not have a duty to consider the interests of individual shareholders.⁵⁷ Following an analysis of case law, it was found that Australian case law suggests that directors should consider the interests of creditors when that company is nearing insolvency.⁵⁸ Directors do not, however, have a direct duty to consider the interests of creditors, according to Australian law.

It was concluded that corporate governance initiatives, such as the *Corporate Responsibility Report* of 2005, favour shareholder primacy, subject thereto that stakeholders such as employees should also be protected. It was indicated that employment contracts and labour legislation seemingly do not provide sufficient protection to employees in Australia. As has been indicated, the protection that a specific stakeholder receives in legislation, other than corporate legislation, plays an important role in deciding whether or not directors should acknowledge the interests of a specific stakeholder.

With regard to consumers, it was found that the Trade Practices Act⁵⁹ provides an extensive list of consumer rights, especially in part V. It seems that consumers receive adequate protection in this Act.⁶⁰

The Australian corporate law review provides guidelines on how directors' duties to a company could be regulated. Firstly, the reports drafted during the corporate

⁵⁵ Chapter 4 par 4.

⁵⁶ Chapter 4 par 4.3.

⁵⁷ Chapter 4 par 3.2.2.

⁵⁸ Chapter 4 par 3.2.3.

⁵⁹ Act 51 of 1974. Chapter 4 par 3.2.5.

⁶⁰ Chapter 4 par 3.2.5.

governance initiatives in Australia are clear and precise. They provide certainty on what is expected of directors, namely that they should act in the best interests of the shareholders collectively, but should also consider the interests of other stakeholders when appropriate. Secondly, it is clear from the Australian position that resistance to a codification, whether partial or comprehensive, is not justified. If a code is drafted in clear terms directors will be certain of their obligations.⁶¹ It seems that courts will initially refer to previous case law when interpreting the code, but that the statutory provisions will become sufficient to rely on based on the fact that they are clearly drafted and in line with the common law.⁶²

2.5 Harmonisation of Business Laws in SADC with Specific Reference to the Position in Botswana

In chapter 5 developments in the Southern African Developmental Community (SADC) are considered, with specific reference to the position in Botswana.⁶³ It is important to consider the laws in SADC countries, because their circumstances are similar to those in South Africa and to facilitate harmonisation of business laws in SADC countries.⁶⁴ The company law of Botswana is given specific consideration, in view of recent developments in that jurisdiction.

It was found that Botswana did not violate SADC's goal of harmonisation by applying New Zealand company law instead of English law.⁶⁵ Botswana's Companies Act of 2003, which is based on the position in New Zealand, states that directors should manage a company in the best interests of the company. This is in line with the United Kingdom's Companies Act of 2006 and the South African Companies Bill of 2007. The best interests of "the company" are interpreted in the United Kingdom, Botswana and South Africa as the shareholders collectively. All of the aforementioned Acts and the Bill provide for a codification of directors' duties,

⁶¹ Chapter 4 par 5.

⁶² Chapter 4 pars 3.1; 5.

⁶³ Chapter 3 par 1.

⁶⁴ Chapter 3 par 1.

⁶⁵ Chapter 5 par 4.

but the South African Companies Bill only provides for a partial codification whereas the Companies Act of Botswana and the Companies Act of the United Kingdom provide for a comprehensive statement of directors' duties.⁶⁶ It was argued elsewhere that there is not a substantial difference between a partial and a comprehensive codification of directors' duties.⁶⁷

2.6 South African Law

In the South African chapter an overview was provided on directors' duties. The traditional interpretation given to "the company as a whole" was also evaluated. The viewpoints of the drafters of the *King Reports*, the *Policy Document* on company law reform and the Draft Companies Bill were evaluated to determine in whose interests directors should manage a company and whether or not directors' duties should be codified in a partial or comprehensive manner. Other protection, than only company legislation, afforded various stakeholders was also investigated. This chapter focused on the primary stakeholders, namely individual shareholders, creditors, employees, consumers and suppliers.⁶⁸

2.6.1 Stakeholder Protection and the Codification of Directors' Duties

A comprehensive study was conducted to determine in whose interests directors should manage a company. It was stated that the traditional viewpoint in South Africa is to manage a company in the best interests of the shareholders collectively.⁶⁹ Corporate social responsibility is, however, of substantial importance when directors manage a company and the protection that different stakeholders receive was considered. Various corporate governance initiatives were evaluated to determine the viewpoints of the drafters on stakeholder protection.⁷⁰

⁶⁶ Chapter 5 par 3.1.3.

⁶⁷ Chapter 4 par 5.

⁶⁸ Chapter 6 par 3.

⁶⁹ Chapter 6 par 2.1.1.

⁷⁰ Chapter 6 par 4.

The viewpoint of the drafters of the *King Reports*, the *Policy Document* and the Draft Companies Bill on codifying directors' duties were also considered. It was argued that the codification of directors' duties is welcome as directors will have more certainty regarding their duties. The common law will still apply to a partial codification, thereby ensuring that directors' duties are still flexible and capable of development. It is important that the relationship between the statutory duties and the common law be clear when opting for a partial code. It was argued that this is currently not the case in terms of the Companies Bill.⁷¹ It was submitted elsewhere that an exhaustive code is also an option as courts will still be able to refer to existing case law when interpreting the code.⁷²

2.6.1.1 Clauses Recommended for Future Company Legislation

The *Policy Document* expresses a clear preference for the enlightened shareholder value approach where the shareholders are of paramount importance when directors manage a company. The interests of stakeholders should also be considered if it promotes profit maximisation for the shareholders, subject to the Constitution and related legislation.⁷³ *King II* refers to the "triple-bottom line"⁷⁴ and inclusive approaches, supporting the fact that other interest groups should be considered as advocated by the enlightened shareholder value approach.⁷⁵ It was argued that the Companies Bill of 2007 is not clear enough on this issue.⁷⁶ On the one hand, the Bill upholds the traditional viewpoint of shareholder primacy, mainly based on the fact that the word "company" is still used and that no reference is made to other stakeholders in clause 91. Stakeholders are only referred to in the remedy provisions in chapter 7, part B of the Bill, and only employees are referred to in the business rescue provisions. On the other hand, the remedy provisions, which provide some

⁷¹ Chapter 6 pars 5.3–5.5.

⁷² Chapter 3 par 4.3.4.

⁷³ Chapter 6 par 4.2.

⁷⁴ The "triple-bottom line" refers to economic, social and environmental factors. Directors should consider all three of these factors when they manage a company.

⁷⁵ Chapter 6 par 4.1.

⁷⁶ Chapter 6 par 4.3.

stakeholders with direct protection, seem to suggest that the traditional viewpoint is no longer applicable.⁷⁷ Thus it is still not absolutely clear in whose interests directors should manage a company. It was suggested that the new Companies Act should eliminate debate on this issue and state in clear terms which approach is preferred.⁷⁸

This inadequacy can be addressed by applying the theory proposed in chapter 2 above. In terms of this theory, it cannot be denied that a company is a separate legal entity, represented by several interests, including those of shareholders, employees, investors, consumers, the community and the environment.⁷⁹ One therefore cannot require directors to act only in the best interests of the shareholders collectively when acting in “the best interests of the company”. The courts need to give different weight to the interests represented in a company. These interests and the weight attached to them may differ during the various stages of a company. The protection that these stakeholders receive by way of means other than company law, may also play a role when a court decides on the competing interests of different stakeholders.⁸⁰

Elsewhere Du Plessis and I⁸¹ therefore proposed that “the company” should be defined in the Act as follows:⁸²

⁷⁷ Chapter 6 par 4.3.

⁷⁸ Chapter 6 par 4.3.

⁷⁹ Chapter 2 par 5.2.

⁸⁰ Chapter 2 par 5.2.

⁸¹ Esser & Du Plessis “Stakeholder Protection” 361.

⁸² Esser and Du Plessis have also proposed draft clauses on the duty of care, skill and diligence and directors’ fiduciary duties. In their article, the duty of care, skill and diligence, and directors’ fiduciary duties were drafted in separate clauses. The discussion in this thesis focuses only on the current clause 91(1)(b) of the Draft Bill and an improved drafting thereof. The clauses that Esser & Du Plessis proposed read as follows:

91. Directors’ duty of care, skill and diligence

A director of a company must exercise his powers and discharge his duties with a degree of care, skill and diligence that a reasonable person would exercise if –

- (a) he is a director of the company; and
- (b) had the same responsibilities within the company as that director.

92. Directors’ fiduciary duties towards the company

- (1) A director of a company must discharge his duties in good faith in the best interests of the company and for a proper purpose;
- (2) A director of a company must not improperly use his position to gain an advantage for himself or another person or to cause harm to the company;

“**company**” means a juristic person to the extent that it is, or its activities are, regulated by this Act in terms of section 7 and includes, from time to time, any or all the interests of –

- (a) the company’s members as a whole;
- (b) the company’s employees;
- (c) the company’s suppliers, customers and others;
- (d) the community and the environment to the extent that it could be affected by the company’s business activities;

The above-mentioned definition of “the company” was proposed for various reasons: firstly, directors should manage a company in the best interests of the company. By defining “a company” directors would be clear who the beneficiaries of their fiduciary duties are. It was argued that it is unclear in whose interests directors should manage a company in terms of the Draft Bill. The drafting of clause 91(1)(b) in the Bill seems to indicate that the traditional viewpoint is still followed, but the remedy provisions seem to indicate otherwise, suggesting that directors have direct duties to certain stakeholders.⁸³

Secondly, the definition states clearly that directors should manage the company in the best interests of the company as a juristic person, which should, from time to time, include other interests. This proposed drafting can be compared with the drafting of section 172 in the United Kingdom Companies Act.⁸⁴ It was indicated that the United Kingdom Companies Act of 2006 is clear on in whose interests directors should manage a company because the specific stakeholders that directors should consider are listed in the Act.⁸⁵ But the practical application was questioned. It was

(3) A person who obtains information in his capacity as a director of a company must not use the information improperly to gain advantage for himself or another person or to cause harm to the company.

93. Presumption in favour of directors

It is presumed that a director fulfilled his duty of care, skill and diligence under section 91 or his fiduciary duties under section 92 if –

- (a) the director –
 - (i) has taken reasonably diligent steps to become informed about the subject matter; and
 - (ii) does not have a personal financial interest in the subject matter; and
- (b) fulfilled the duty in the same way as a reasonable person in a similar position would do in comparable circumstances.

⁸³ Chapter 6 par 4.3.

⁸⁴ Chapter 3 par 4.3.3.

⁸⁵ Chapter 3 par 4.3.3.

indicated that, in terms of section 172 of the United Kingdom Companies Act, the shareholders collectively are still the main beneficiary of directors' duties and that the stakeholders listed have no enforceable rights.⁸⁶

The proposed drafting differs in two ways from section 172. Firstly, the company, as a separate legal entity, and not the shareholders collectively, is the primary beneficiary of directors' duties. The suggested definition of "the company" is based on the proposed theory and provides that directors should manage a company in the best interests of the company as a separate legal entity. The shareholders collectively should not be the primary beneficiary of directors' duties. This conclusion was reached after traditional arguments for exclusive shareholder protection were considered and it was found that there are a number of shortcomings in the arguments.⁸⁷ It was further argued that to act in the best interests of the company as a separate legal entity, directors should consider the interests of various stakeholders.⁸⁸ Which stakeholder to consider will depend on the specific circumstances of the company.⁸⁹ This means that different stakeholders should be protected at different times of a company's existence. That is why "from time to time, any or all the interests of" has been added to the definition. Directors should therefore strive to act in the best interests of the company and act in the interests of the specific stakeholder that will best give effect to the interests of the company. The protection that stakeholders receive elsewhere is important as that will help directors to determine whether they should protect a specific stakeholder or not.

Secondly, it is important to consider whether the stakeholders mentioned in the proposed definition would have enforceable rights. It is argued that any of the stakeholders listed in the proposed definition of "the company" should be able to institute action if a director did not act in the best interests of the company. In this way any stakeholder can ensure that directors manage a company in the best interests

⁸⁶ Chapter 3 par 4.3.3.2.

⁸⁷ Chapter 3 par 5.1.1.

⁸⁸ Chapter 3 par 5.2.

⁸⁹ Chapter 3 par 5.2.

of the company, as a separate legal entity, and therefore indirectly in their interest. This does not imply that stakeholders may also institute action if their personal interests were affected, the interests of the company is still of paramount importance.

In the light hereof, clause 166 (statutory derivative action) should be amended. Currently “shareholders, directors or registered trade unions or representatives of employees” may institute a derivative action to protect the interests of the company. I suggest that employees, creditors, consumers and other relevant stakeholders should also be able to institute a derivative action. There is no reason why only shareholders and employee representatives should have this right.

Clause 164, in its current format, is also problematic. Currently, clause 164 states that “a shareholder, creditor or director of a company may apply to a court for relief if any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant”. It was argued in chapter 6⁹⁰ that this creates the impression that directors have direct fiduciary duties to shareholders and creditors because it is stated in the clause that they may apply for relief if their own interests have been prejudiced. This should be amended to only provide individual shareholders with such a right. It was indicated in chapter 6⁹¹ that individual shareholders do not receive sufficient protection elsewhere. It is therefore justified to provide them with protection in company legislation.

The above-mentioned recommendations can be explained by way of the following scenario. If a director did not consider the interests of a specific stakeholder during company management, that stakeholder can argue that the director did not act in the best interests of the company as a separate legal entity by using clause 166 of the Bill. For example, the directors did not consider the interests of employees during a restructuring of the company, but only focused on profit maximisation for the shareholders. The employees can argue that it would have been in the best interests of

⁹⁰ Chapter 6 par 4.3 above.

⁹¹ Chapter 6 par 3.1 above.

the company to consider their interests. They can argue, for instance, that it would have been in the best interests of the company to have experienced employees, even if the cost to the company to employ them was higher. Directors would also have to determine whether they need to consider the employees' interests or whether there are adequate labour legislation protecting their interests.⁹²

If "the company" is clearly defined, it would be possible for directors to act in the best interests of the company (as stated in clause 91(1)(b) of the Bill), because they will be clear on what is meant by "the company".

However, in chapter 6 a number of problems in the drafting of clause 91(1)(b) were discussed. The current clause 91(1)(b) reads as follows:

a second, fiduciary, duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests of, and for the benefit of, the company.

The problems discussed include that, firstly, it seems as if "honestly" and "good faith" are treated as two separate issues. It is unclear as to what the difference is between these two concepts. Secondly, the clause provides that directors should act in the best interests and for the benefit of the company. It is not clear what is meant by "benefit". It is uncertain if this term only relates to a financial benefit or whether any benefit is relevant. By not qualifying "benefit" it can be argued that it implies that all benefits are relevant when directors manage a company.⁹³ A clause regulating directors' duty of good faith should read as follows:

A director of a company must discharge his duties in good faith in the best interests of the company.

By deleting "honestly" and "benefit" the potential for confusion is removed.

⁹² Protection afforded employees in terms of labour legislation was discussed in ch 6 par 3.3.

⁹³ Chapter 6 par 4.3.

2.6.2 Protection Afforded Stakeholders

It was indicated above that any other protection given to various stakeholders should play a role when a court decides on the competing interests of different stakeholders. The protection afforded individual shareholders, creditors, employees and consumers was considered. It was seen that directors do not have direct fiduciary duties to individual shareholders.⁹⁴ It was indicated that specific directors may incur duties towards specific shareholders when an established legal relationship, such as agency, is present. But if no such relationship is present, then shareholders do not have adequate protection.⁹⁵

With regard to employees, different options were explored to determine whether or not they are adequately protected.⁹⁶ Firstly, it was indicated that worker participation on board level does not seem to be practical in South Africa. It was argued that worker participation will not work in a unitary board structure, even where the unitary board structure has similarities to the two-tier board structure, as is the case in South Africa.⁹⁷ The fact that employees are not the only other interest group is another reason not to have worker participation on board level. It will be impractical to provide consumers, suppliers and the general public with board representation and there is no compelling reason why employees should receive priority above the other stakeholders. Secondly, workplace forums are another method for employees to participate in company management. These forums are for various reasons currently not widely implemented in South Africa, but it remains a valid option.⁹⁸ Thirdly, collective bargaining may also protect employees since it enables management to discuss issues that are important to employees with their representatives. It was acknowledged that collective bargaining has shortcomings, but it provides a platform for employees to voice their concerns through their trade union representatives with regard to the terms and conditions of their employment. Fourthly, employees can also

⁹⁴ Chapter 6 par 3.1.

⁹⁵ Chapter 3 par 3.1.

⁹⁶ Chapter 6 par 3.3.

⁹⁷ Chapter 6 par 3.3.2.1.

⁹⁸ Chapter 6 par 3.3.2.2.

be directors. This is usually so in the case of managing directors. Should there be a conflict of interests the specific director should abstain from voting.⁹⁹ Employees therefore have various means of protection in labour law legislation in South Africa.¹⁰⁰

The position of creditors was also considered. Arguments were raised for and against a direct duty towards creditors.¹⁰¹ The majority of cases indicated that this duty towards creditors should be an indirect duty.¹⁰² Because of the shortcomings in the protection currently afforded creditors, mainly the problems associated with section 424 of the Companies Act and contractual protection, it is submitted that directors should have fiduciary duties to creditors in certain instances.¹⁰³ In other words, the interests of creditors would sometimes receive priority. The rationale for this argument lies in the fact that the company is effectively trading with only the creditors' money when the company is in financial distress. The cases do not provide clear guidelines as to when such a duty would arise.¹⁰⁴ Keay suggests an objective test on when a duty to creditors should arise. He states that the best trigger would be that the circumstances of a specific company indicate that a director could reasonably be able to expect that his or her actions could lead to insolvency of the company.¹⁰⁵ I agree that this is the best option to determine when directors should consider the interests of creditors. I therefore submit that directors should consider the interests of creditors in certain instances, even if this consideration can be to the detriment of the shareholders. These instances include when a company is in financial difficulty.¹⁰⁶

⁹⁹ Chapter 6 par 3.3.3.

¹⁰⁰ Chapter 6 par 3.3.3.

¹⁰¹ Chapter 6 par 3.2.2.

¹⁰² Chapter 3 par 3.1.3; ch 4 par 3.2.3.

¹⁰³ Chapter 6 par 3.2.2.

¹⁰⁴ The following problems were identified: when does a duty to creditors arise and who is the beneficiary of such a duty (ch 6, par 3.2.3.)

¹⁰⁵ Chapter 6 par 3.2.3.

¹⁰⁶ Chapter 6 par 3.2.3.3.

It was shown that consumers also receive adequate protection, especially in statutes on consumer protection, competition law and credit regulation.¹⁰⁷ The Consumer Protection Bill, in particular, provides general protection in a wide variety of instances to consumers.¹⁰⁸

To conclude, the recommendations in this chapter are based on the following: firstly, a theory was recommended where the company as a separate legal entity is the primary beneficiary of directors' duties. When acting in the best interests of the company, the directors should have regard to the interests of various stakeholders, if the consideration of their interests will benefit the company. Which stakeholder should get specific attention at a given time will vary during the different stages of the existence of a company. Secondly, directors need to be aware of other measures protecting the various stakeholders as this should play a role when directors decide which stakeholder to consider when managing a company. Thirdly, it was proposed that "the company" should be defined. In terms of the proposed definition, directors would be clear in whose interests they should manage a company. If "the company" is clearly defined a clause stating that "a director of a company must discharge his duties in good faith in the best interests of the company" is sufficient. These recommendations are derived from an evaluation of directors' duties, various corporate governance initiatives and protection afforded different stakeholders in Australia, the United Kingdom, Botswana and South Africa.

It is therefore suggested that the recognition of other protective measures, the proposed theory and the proposed clauses in the new company legislation will contribute to a clearer understanding of the issue in whose interests directors manage a company at any given time.

¹⁰⁷ Chapter 6 par 3.4.2. This thesis focused on the statutory protection, other than company law, available to various stakeholders.

¹⁰⁸ Chapter 6 par 3.4.2.1. This Bill should be approved by Parliament during May 2008.

BIBLIOGRAPHY

JOURNAL ARTICLES

Alchain & Demsetz “Production, Information Costs”

Alchain A, Demsetz H “Production, Information Costs, and Economic Organization” (1972) 62 *American Economic Review* 777–795.

Alcock “Corporate Governance: A Defence Against the Status Quo”

Alcock A “Corporate Governance: A Defence Against the Status Quo” (1995) 58 *Modern Law Review* 898–912.

André “Some Reflections on German Corporate Governance”

André TJ “Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards” (1996) 70 *Tulane Law Review* 1819–1879.

Arden “Reforming the Companies Acts”

Arden Rt Hon Lady Justice “Reforming the Companies Acts: The Way Ahead” (2002) (November) *Journal of Business Law* 579–600.

Armstrong “The King Report on Corporate Governance”

Armstrong P “The King Report on Corporate Governance” (1995) 3 *Juta’s Business Law* 65–70.

Arsalidou “Shareholder Primacy”

Arsalidou D “Shareholder Primacy in Clause 173 of the Company Law Bill 2006” (2007) 28 *The Company Lawyer* 67–69.

Attenborough “The Company Law Reform Bill”

Attenborough D “The Company Law Reform Bill: An Analysis of Directors’ Duties and the Objective of the Company” (2006) 27 *The Company Lawyer* 162–169.

Attenborough “Recent Developments in Australian Corporate Law”

Attenborough D “Recent Developments in Australian Corporate Law and Their Implications for Directors’ Duties: Lessons to be Learned from the UK Perspective” (2007) 18 *International Company and Commercial Law Review* 312–323.

Baloro “Corporate Law and National Development”

Baloro J “Corporate Law and National Development: Corporate Law Reform in Swaziland” (1996) 29 *CILSA* 130–140.

Bamodu “Transnational Law”

Bamodu G “Transnational Law, Unification and Harmonization of International Commercial Law in Africa” (1994) 38 *Journal of African Law* 125–143.

Barnard “The Hampel Committee Report”

Barnard JW “The Hampel Committee Report: A Transatlantic Critique” (1998) 19 *The Company Lawyer* 110–115.

Barrett “Directors’ Duties to Creditors”

Barrett R “Directors’ Duties to Creditors” (1977) 40 *The Modern Law Review* 226–231.

Baxt & Brunt “Guide to the Trade Practices Act”

Baxt R, Brunt M “A Guide to the Trade Practices Act 1974” (1974) 4 *The Australian Economic Review* 5–22.

Belcher “Compliance with the Cadbury Code”

Belcher A “Compliance with the Cadbury Code and the Reporting of Corporate Governance” (1996) 17 *The Company Lawyer* 11–17.

Berkahn “Directors Duties”

Berkahn M “Directors Duties to ‘the Company’ and to Creditors: *Spies v The Queen*” (2001) 6 *Deakin Law Review* 360–372.

Berle “Corporate Powers”

Berle AA “Corporate Powers as Powers in Trust” (1931) 44 *Harvard Law Review* 1049–1074.

Berle “For Whom Corporate Managers Are Trustees”

Berle AA “For Whom Corporate Managers Are Trustees: A Note” (1932) 45 *Harvard Law Review* 1365–1372.

Berle “The Impact of the Corporation”

Berle AA “The Impact of the Corporation on Classical Economic Theory” (1965) 79 *Quarterly Journal of Economics* 25–40.

Beuthin “The Range of a Company’s Interests”

Beuthin RC “The Range of a Company’s Interests” (1969) 86 *South African Law Journal* 155–178.

Blackmore “Regulating Regime”

Blackmore J “Evaluating New Zealand’s Evolving Corporate Governance Regulatory Regime in a Comparative Context” (2006) 12 *The Canterbury Law Review* 34–64.

Bolodeoku “Economic Theories”

Bolodeoku IO “Economic Theories of the Corporation and Corporate Governance: A Critique” (2002) July *Journal of Business Law* 411–438.

Boraine “Towards Codifying the Actio Pauliana”

Boraine A “Towards Codifying the Actio Pauliana” (1996) 8 *South African Mercantile Law Journal* 213–232.

Botha “Directors’ Fiduciary Duties to Bondholders?”

Botha D “Directors’ Fiduciary Duties to Bondholders? Some Relationships between Corporate Financial Management and Fiduciary Law” (1993) 5 *South African Mercantile Law Journal* 287–299.

Botha “Confusion in the King Report”

Botha D “Confusion in the King Report” (1996) 8 *South African Mercantile Law Journal* 26–39.

Botha “Holding and Subsidiary Companies”

Botha DH “Holding and Subsidiary Companies: Fiduciary Duties of Directors” (1983) 16 *De Jure* 234–243.

Bottomley “Contractualism to Constitutionalism”

Bottomley S “From Contractualism to Constitutionalism: A Framework for Corporate Governance” (1997) 19 *Sydney Law Review* 277–313.

Bottomley “The Birds, the Beasts, and the Bat”

Bottomley S “The Birds, the Beasts, and the Bat: Developing a Constitutionalist Theory of Corporate Regulation” (1999) 27 *Federal Law Review* 243–264.

Bottomley & Forsyth “Corporate Law”

Bottomley S, Forsyth A “The New Corporate Law” (2005) November available at www.monash.edu.au/depts/blt/clargworking-paper1.pdf 2–24

Cairncross & Buultjens “Enterprise Bargaining”

Cairncross G, Buultjens J “Enterprise Bargaining Under the Workplace Relations Act 1996 in Construction and Hospitality Small Businesses: A Comparative Study” (2006) 48 *Journal of Industrial Relations* 475–489.

Campbell “Does the Companies Act Codify Remedies?”

Campbell N “Editorial: Does the Companies Act Codify Remedies?” (2001) 4 *New Zealand Business Law Quarterly* 53–54.

Cassidy “Standards of Conduct”

Cassidy J “Standards of Conduct and Standards of Review: Divergence of the Duty of Care in the United States and Australia” (2000) 28 *Australian Business Law Review* 180–204.

Cassim “Fraudulent or Reckless Trading”

Cassim FHI “Fraudulent or ‘Reckless’ Trading and Section 424 of the Companies Act” (1981) 98 *South African Law Journal* 162–172.

Cassim “Reform of Corporate Law in South Africa”

Cassim R “Reform of Corporate Law in South Africa” (2005) 16 *International Company and Commercial Law Review* 411–418.

Cheffins “Current Trends in Corporate Governance”

Cheffins BR “Current Trends in Corporate Governance: Going from London to Milan via Toronto” (1999) 10 *Duke Journal of Comparative and International Law* 5–42.

Cheffins “Teaching Corporate Governance”

Cheffins BR “Teaching Corporate Governance” (1999) 19 *Legal Studies* 515–525.

Cheung “The Contractual Nature of the Firm”

Cheung SNS “The Contractual Nature of the Firm” (1983) 26 *Journal of Law and Economics* 1–21.

Clarke “The Stakeholder Corporation”

Clarke T “The Stakeholder Corporation: A Business Philosophy for the Information Age” (1998) 31 *Long Range Planning* 182–194.

Clarkson “A Stakeholder Framework”

Clarkson ME “A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance” (1995) 20 *Academy of Management Review* 92–117.

Coase “The Nature of the Firm”

Coase RH “The Nature of the Firm” (1937) 4 *Economica* 386–405.

Coffee “What Caused Enron?”

Coffee Jr JC “What Caused Enron? A Capsule Social and Economic History of the 1990s” (2004) 89 *Cornell Law Review* 269–309.

Copp “Corporate Governance: Part 2”

Copp S “Corporate Governance: Change, Consistency and Evolution: Part 2” (2003) 14 *International Company and Commercial Law Review* 115–128.

Crook “The Good Company”

Crook C “The Good Company” (2005) January *The Economist* 1–18.

Dabscheck B “The Slow and Agonising Death of the Australian Experiment with Conciliation and Arbitration”

Dabscheck B “The Slow and Agonising Death of the Australian Experiment with Conciliation and Arbitration” (2001) 43 *Journal of Industrial Relations* 277–293.

Davies “Employee Representation”

Davies P “Employee Representation and Corporate Law Reform: A Comment from the United Kingdom” (2000) 22 *Comparative Labor Law and Policy Journal* 135–148.

Dawson “Acting in the Best Interest of the Company”

Dawson F “Acting in the Best Interest of the Company – for Whom are Directors ‘Trustees’?” (1984) 11 *New Zealand Universities Law Review* 68–81.

Deakin “Transformation of Shareholder Value”

Deakin S “The Coming Transformation of Shareholder Value” (2005) 13 *Corporate Governance* 11–18.

Dean “Stakeholding and Company Law”

Dean J “Stakeholding and Company Law” (2001) 22 *The Company Lawyer* 66–74.

Dean ”Unfair Contract Terms”

Dean M “Unfair Contract Terms: The European Approach” (1993) 56 *Modern Law Review* 581–590.

De La Rey “Vroeë Maatskappyereg”

De la Rey EM “Aspekte van die Vroeë Maatskappyereg: ’n Vergelykende Oorsig (Deel 1)” (1986) 27 *Codicillus* 4–15.

Delport “European Community Directives”

Delport P “European Community Directives on the Harmonization of Company Law and United Kingdom Company Law: A Status Report” (1992) 4 *South African Mercantile Law Journal* 198–209.

Delport “Werkplekforums”

Delport P “Korporatiewe Reg en Werkplekforums” (1995) 28 *De Jure* 409–418.

DeMott “Fiduciary Obligation”

DeMott DA “Beyond Metaphor: An Analysis of Fiduciary Obligation” (1988) 5 *Duke Law Journal* 879–924.

Dignam “Exporting Corporate Governance”

Dignam A “Exporting Corporate Governance: UK Regulatory Systems in a Global Economy” (2000) 21 *The Company Lawyer* 70–76.

Dignam “Lamenting Reform?”

Dignam A “Lamenting Reform? The Changing Nature of Common Law Corporate Governance Regulation” (2007) 25 *Company and Securities Law Journal* 283–299.

Dine “Company Law Developments”

Dine J “Company Law Developments in the European Union and the United Kingdom: Confronting Diversity” (1998) *Tydskrif vir die Suid- Afrikaanse Reg* 245–259.

Dodd “For Whom are Corporate Managers Trustees?”

Dodd EM “For Whom are Corporate Managers Trustees?” (1932) 45 *Harvard Law Review* 1145–1163.

Dodd “Book Review”

Dodd EM Book Review on ME Dimock & HK Hyde *Bureaucracy and Trusteeship in Large Corporations* (1940) in (1942) 9 *University of Chicago Law Review* 538–549.

Donaldson & Preston ”The Stakeholder Theory”

Donaldson T, Preston LE “The Stakeholder Theory of the Corporation: Concepts, Evidence, Implications” (1995) 20 *Academy of Management Review* 65–91.

Du Plessis “Werkersdeelneming”

Du Plessis JJ “Werkersdeelneming in die Bestuursorgane van ’n Maatskappy” (1981) 44 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 380–395.

Du Plessis “Diskwalifikasie en Persoonlike Aanspreeklikheid”

Du Plessis JJ “Diskwalifikasie en Persoonlike Aanspreeklikheid van Direkteure: Belangwekkende Ontwikkelings in die Engelse Reg” (1989) 10 *De Rebus* 435–441.

Du Plessis “Enkele Internasionale Maatskappyregtelike Ontwikkelings”

Du Plessis JJ “Enkele Internasionale Maatskappyregtelike Ontwikkelings: Moet Ons Navolg?” (1992) *Tydskrif vir die Suid-Afrikaanse Reg* 561–578.

Du Plessis “Direkteure se Pligte Teenoor Partye Anders as die Maatskappy”

Du Plessis JJ “Direkteure se Pligte Teenoor Partye Anders as die Maatskappy” (1992) 25 *De Jure* 378–392.

Du Plessis “Prominensie van die Statute”

Du Plessis JJ “Beskikkingsvryheid oor Interne Bestuursorganisasie, Interne Bevoegdheidsverdeling en die Prominensie van die Statute in die Maatskappyreg” (1992) *Tydskrif vir die Suid-Afrikaanse Reg* 94–103.

Du Plessis “Die Algemene Vergadering en die Direksie”

Du Plessis JJ “Die Status van die Algemene Vergadering en die Direksie in die Interne Maatskappyopset” (1992) *Tydskrif vir die Suid-Afrikaanse Reg* 267–279.

Du Plessis “Some International Developments”

Du Plessis JJ “Some International Developments in Company Law: A South African Perspective” (1993) 14 *The Company Lawyer* 224–231.

Du Plessis “Corporate Governance”

Du Plessis JJ “Corporate Governance and the Cadbury Report” (1994) 6 *South African Mercantile Law Journal* 81–90.

Du Plessis “Corporate Governance Reflections on the German System”

Du Plessis JJ “Corporate Governance: Reflections on the German Two-Tier Board System” (1996) *Tydskrif vir die Suid-Afrikaanse Reg* 20–46.

Du Plessis “Corporate Governance Reforms in Germany”

Du Plessis JJ “Reflections on Some Recent Corporate Governance Reforms in Germany: A Transformation of the German Aktienrecht?” (2003) 8 *Deakin Law Review* 381–396.

Du Plessis “Reverberations After the HIH”

Du Plessis JJ “Reverberations After the HIH and Other Recent Australian Corporate Collapses: The Role of ASIC” (2003) 15 *Australian Journal of Corporate Law* 225–245.”

Du Plessis & Dine “The Fate of the Draft Fifth Directive”

Du Plessis JJ, Dine J “The Fate of the Draft Fifth Directive on Company Law: Accommodation Instead of Harmonisation” (1997) *Journal of Business Law* 23–47.

Du Plessis “The German Two-Tier Board”

Du Plessis JJ “The German Two-Tier Board and the German Corporate Governance Code” (2004) 15 *European Business Law Review* 1139–1164.

Edwin “White Paper and the Draft Companies Bill Published”

Edwin J “White Paper and the Draft Companies Bill Published” (2002) 23 *The Company Lawyer* 308–309.

Eisenberg “The Conception that the Corporation is a Nexus of Contracts”

Eisenberg MA “The Conception that the Corporation is a Nexus of Contracts and the Dual Nature of the Firm” (1999) 24 *Journal of Corporation Law* 819–836.

Esser & Coetzee “Codification of Directors’ Duties”

Esser I, Coetzee J “Codification of Directors’ Duties” (2004) 12 *Juta’s Business Law* 26–31.

Esser “The Enlightened-Shareholder-Value Approach”

Esser I “The Enlightened-Shareholder-Value Approach Versus Plurism in the Management of Companies” (2005) 26 *Obiter* 719–725.

Esser “The Protection of Employees”

Esser I “Stakeholder Protection: The Position of Employees” (2007) 70 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 407–426.

Esser & Du Plessis “Stakeholder Protection”

Esser I, Du Plessis JJ “The Stakeholder Debate and Directors’ Fiduciary Duties” (2007) 19 *South African Mercantile Law Journal* 346–363.

Fairfax “The Rhetoric of Corporate Law”

Fairfax LM “The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms” (2006) 31 *The Journal of Corporation Law* 675–718.

Fama & Jensen “Separation of Ownership and Control”

Fama EF, Jensen MC “Separation of Ownership and Control” (1983) 26 *Journal of Law and Economics* 301–325.

Finch “Directors’ Duties Towards Creditors”

Finch V “Directors’ Duties Towards Creditors” (1989) 10 *The Company Lawyer* 23–25.

Fisch “Measuring Efficiency”

Fisch JE “Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy” (2006) 31 *The Journal of Corporation Law* 637–674.

Flannigan “Fiduciary Doctrine”

Flannigan R “The Adulteration of Fiduciary Doctrine in Corporate Law” (2006) 122 *Law Quarterly Review* 449–468.

Floor “Consumer Protection Bill”

Floor J “Consumer Protection Bill” 08/05/2006 available at <http://www.floor-inc.co.za/news/article.asp?newsID=72> (accessed 10 April 2007).

Forsyth “Corporate Accountability to Employees”

Forsyth A “Corporate Accountability to Employees: Exploring the Limits of CSR” (2006) 3 *Monash Business Review* 1–7.

Fourie “Die Plig van Direkteure Teenoor Maatskappyskuldeisers”

Fourie OJS “Die Plig van Direkteure Teenoor Maatskappyskuldeisers” (1992) 4 *South African Mercantile Law Journal* 25–52.

Fourie “Dorklerk Investments”

Fourie JSA “Dorklerk Investments (Pty) Ltd v BHYAT 1980 1 SA 443 (W)” (1980) 43 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 328–330.

Fourie “Vertrouenspligte”

Fourie JSA “Vertrouenspligte en Intrakorporatiewe Verhoudings” (1985) 10 *Tydskrif vir Regswetenskap* 119–138.

Fourie “South African Corporate Law Reform”

Fourie JSA “South African Corporate Law Reform – Lessons from Abroad” (1994) *Tydskrif vir die Suid-Afrikaanse Reg* 770–786.

Freeman & Evan “Corporate Governance”

Freeman RE, Evan WM “Corporate Governance: A Stakeholder Interpretation” (1990) 19 *Journal of Behavioural Economics* 337–359.

Frost “Introduction to Classical legal rhetoric”

Frost M “Introduction to Classical Legal Rhetoric: A Lost Heritage” (1999) 8 *Southern California Interdisciplinary Law Journal* 613–643.

Gautreau “Fiduciary Principle”

Gautreau JR “Demystifying the Fiduciary Principle” (1989) 68 *Canadian Bar Review* 1–29.

Goddard “Modernising Company Law”

Goddard R “Modernising Company Law: The Government’s White Paper” (2003) 66 *Modern Law Review* 402–424.

Goode “The Codification of Commercial Law”

Goode R “The Codification of Commercial Law” (1988) 14 *Monash University Law Review* 135–157.

Gordon “What Enron Means for Management”

Gordon JN “What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections” (2002) 69 *University of Chicago Law Review* 1233–1250.

Grantham “The Judicial Extension of Directors’ Duties to Creditors”

Grantham R “The Judicial Extension of Directors’ Duties to Creditors” (1991) *Journal of Business Law* 1–18.

Grantham “Corporate Governance Codes”

Grantham R “Corporate Governance Codes in Australia and New Zealand: Propriety and Prosperity” (2004) 23 *University of Queensland Law Journal* 218–225.

Greenfield “Using Behavioral Economics

Greenfield K “Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool” (2001–2002) 35 *University of California Davis Law Review* 581–644.

Hadjinestoros “Exploitation of Business Opportunity”

Hadjinestoros M “Exploitation of Business Opportunity: How the UK Courts Ensure that Directors Remain Loyal to their Companies” (2008) 19 *International Company and Commercial Law Review* 70–77.

Hahlo “Codifying the Common Law”

Hahlo HR “Codifying the Common Law: Protracted Gestation” (1975) 23 *Modern Law Review* 23–30.

Hansmann “Ownership of the Firm”

Hansmann H “Ownership of the Firm” (1988) 4 *Journal of Law, Economics, and Organisation* 267–304.

Hansmann & Kraakman “The End of History for Corporate Law”

Hansman H, Kraakman R “The End of History for Corporate Law” (2001) 89 *Georgetown Law Journal* 439–468.

Hargovan “Directors’ Duties to Creditors”

Hargovan A “Directors’ Duties to Creditors in Australia After *Spies v The Queen* – Is the Development of an Independent Fiduciary Duty Dead or Alive?” (2003) 21 *Company and Securities Law Journal* 390–409.

Hart “Corporate Governance”

Hart O “Corporate Governance: Some Theory and Implications” (1995) 105 *The Economic Journal* 678–689.

Harris “Company Law Reform Bill”

Harris J “Law Society Issues Criticism of Company Law Reform Bill at Second Reading” (2006) 27 *The Company Lawyer* 95–96.

Havenga “Creditors, Directors and Personal Liability”

Havenga MK “Creditors, Directors and Personal Liability Under Section 424 of the Companies Act” (1992) 4 *South African Mercantile Law Journal* 63–69.

Havenga “Corporate Opportunities”

Havenga MK “Corporate Opportunities: A South African Update (Part 1)” (1996) 8 *South African Mercantile Law Journal* 40–55.

Havenga “Breach of Directors’ Fiduciary Duties”

Havenga MK “Breach of Directors’ Fiduciary Duties: Liability on what Basis?” (1996) 8 *South African Mercantile Law Journal* 366–376.

Havenga “The Company, the Constitution and the Stakeholders”

Havenga MK “The Company, the Constitution and the Stakeholders” (1996) 5 *Juta’s Business Law* 134–139.

Havenga “Directors’ Fiduciary Duties Under our Future Company-law Regime”

Havenga MK “Directors’ Fiduciary Duties under our Future Company-law Regime” (1997) 9 *South African Mercantile Law Journal* 310–324.

Havenga “Director’s Personal Liability”

Havenga MK “Director’s Personal Liability for Reckless Trading” (1998) 61 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 719–722.

Havenga “Corporations and the Right to Equality”

Havenga MK “Corporations and the Right to Equality” (1999) 62 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 495–507.

Havenga “The Business Judgment Rule”

Havenga MK “The Business Judgment Rule – Should we Follow the Australian Example” (2000) 12 *South African Mercantile Law Journal* 25–37.

Havenga “The Business Judgment Rule”

Havenga Mk “The Business Judgment Rule: Should We Follow the Australian Example” (2000) 12 *South African Mercantile Law Journal* 25–37.

Havenga “Close Corporations Law 2002”

Havenga “Close Corporations Law 2002: A Review of Recent Cases” (2003) 11 *Juta’s Business Law* 130–132.

Havenga “Regulating Directors’ Duties”

Havenga MK “Regulating Directors’ Duties and South African Company Law Reform” (2005) 26 *Obiter* 609–621.

Havenga “Recent Cases”

Havenga MK “Recent Cases on Company Law” (2005) 13 *Juta’s Business Law* 136–138.

Havenga “Duties of the Company Chairman”

Havenga MK “Duties of the Company Chairman” (2005) 17 *South African Mercantile Law Journal* 137–149.

Henning “The Future of Entrepreneurial Law”

Henning JJ “The Future of Entrepreneurial Law: The SAC’s Proposed Strategic Framework for Reform” (1999) 24 *Journal for Juridical Science* 58–88.

Henning & Du Toit “Financial Markets in the Southern Development Community”

Henning J, Du Toit S “Financial Markets in the Southern African Development Community: The Harmonisation and Approximation of Commercial Laws” (2003) 28 *Journal for Juridical Science* 40–70.

Henning & Wandrag “Oorsig van die Herkoms van die Private Maatskappy”

Henning JJ, Wandrag MS “n Oorsig van die Herkoms van die Private Maatskappy en die Huidige Posisie in Enkele Regstelsels” (1993) 26 *De Jure* 14–41

Hippert “Compliance with the King Code”

Hippert G “Compliance with the King Code: What Should a Good Compliance Statement Include?” (1997) 5 *Juta’s Business Law* 86–88.

Hippert “The Business Judgment Test”

Hippert G “The King Report’s Recommended ‘Business Judgement Test’” (1997) 5 *Juta’s Business Law* 18–20.

Hodes “The Social Responsibility of a Company”

Hodes L “The Social Responsibility of a Company” (1983) 100 *South African Law Journal* 468–495.

Hopt “The German Two-Tier Board”

Hopt KJ “The German Two-Tier Board: Experience, Theories, Reforms” (1998) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=159555#PaperDownload (assessed 8 May 2008).

Gill “Fiduciary Duties”

Gill JA “A Man Cannot Serve Two Masters: The Nature, Existence and Scope of Fiduciary Duties” (1989) 2 *Journal of Contract Law* 115–147.

Gregory “Overview of Corporate Governance”

Gregory HJ “Overview of Corporate Governance Guidelines & Codes of Best Practice in Developing and Emerging Markets” (1999) available at <http://www.afic.am/CG/OVERVIEWOFCORPORATEGOVERNANCE.pdf> (assessed 1 October 2007).

Jensen & Meckling “Theory of the Firm”

Jensen MC, Meckling WH “The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” (1976) 3 *Journal of Financial Economics* 305–360.

Jensen “Self-interest”

Jensen MC “Self-interest, Altruism, Incentives, and Agency Theory” (1994) 7 *Journal of Applied Corporate Finance* 40–55.

Jensen “Value Maximization”

Jensen MC “Value Maximization, Stakeholder Theory, and the Corporate Objective Function” (2001) 14 *Journal of Applied Corporate Finance* 8–21.

Jones “Directors’ Duties”

Jones C “Directors’ Duties: A Supporting Statement” (2005) 16 *International Company and Commercial Law Review* 364–368.

Keay “Interests of Company Creditors: When is it Triggered?”

Keay A “The Director’s Duty to Take into Account the Interests of Company Creditors: When is it Triggered?” (2001) 25 *Melbourne University Law Review* 315–339.

Keay “The Duty to Creditors”

Keay A “The Duty of Directors to Take Account of Creditors’ Interests: Has it Any Role to Play?” (2002) July *Journal of Business Law* 379–410.

Keay “Directors Taking into Account Creditors’ Interests”

Keay A “Directors Taking into Account Creditors’ Interests” (2003) 24 *The Company Lawyer* 300–306.

Keay “Directors’ Duties to Creditors”

Keay A “Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors” (2003) 66 *Modern Law Review* 665–699.

Keay “Section 172(1)”

Keay A “Section 172(1) of the Companies Act 2006: An Interpretation and Assessment” (2007) 28 *The Company Lawyer* 106–110.

Keay “Enlightened Shareholder Value”

Keay A “Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective” (2006) *Lloyds Maritime and Commercial Law Quarterly* 335–361.

Keay “Shareholder Primacy”

Keay A “Shareholder Primacy and the Advent of Enlightened Shareholder Value in the Reform of Directors’ Duties in the United Kingdom” available at <http://users.austlii.edu.au/clta/papers-archive.html> (assessed 1 October 2007).

Kiggundu “Company Law Reform in Botswana”

Kiggundu J “Company Law Reform in Botswana: The Agenda for the Twenty-First Century” (1996) 113 *South African Law Journal* 496–519.

Kiggundu “Modern Company Law”

Kiggundu J “Modern Company Law Reform for the New Millennium: The Botswana Model” (2002) 4 *International and Comparative Corporate Law Journal* 101–131.

Kiggundu & Havenga “The Regulation of Directors’ Self-Serving Conduct”

Kiggundu J, Havenga MK “The Regulation of Directors’ Self-Serving Conduct: Perspectives from Botswana and South Africa” (2004) 37 *The Comparative and International Law Journal of Southern Africa* 272–293.

Klein & Du Plessis “Corporate Donations”

Klein E, Du Plessis JJ “Corporate Donations, the Best Interest of the Company and the Proper Purpose Doctrine” (2005) 28 *The University of New South Wales Law Journal* 69–97.

Kostant “Team Production”

Kostant PC “Team Production and the Progressive Corporate Law Agenda” (2002) 35 *University of California Davis Law Review* 667–704.

Langton & Trotman “The Best Interests of the Corporation”

Langton R & Trotman L “Defining the ‘Best Interests of the Corporation’: Some Australian Reform Proposals” (1999) 3 *Flinders Journal of Law Reform* 163–181.

Larkin “The Fiduciary Duties of the Company Director”

Larkin M “The Fiduciary Duties of the Company Director Parts I–IV” (1979) *The South African Company Law Journal* E1–E40.

Le Roux “Access to Information”

Le Roux PAK “Access to Information: The Promotion of Access to Information Act and Implications for Employers” (2001) 10 *Contemporary Labour Law* 101–110.

Linklater “Codifying Directors’ Duties”

Linklater L “Codifying Directors’ Duties: Better in Principle than in Practice?” (2002) 23 *The Company Lawyer* 261–262.

Linklater “Promoting Success”

Linklater L “Promoting Success: The Companies Act 2006” (2007) 28 *The Company Lawyer* 129–130.

Locke “Fiduciary Duties Towards Creditors”

Locke N “Fiduciary Duties Towards Creditors” (July 2003) Law Teachers’ Conference unpublished paper.

Locke “Access to a Company’s Accounting Records”

Locke N “Access to a Company’s Accounting Records by Means of the Promotion of Access to Information Act 2 of 2000” (2005) 17 *South African Mercantile Law Journal* 221–234.

Lombard “’n Historiese Perspektief 1”

Lombard S “’n Historiese Perspektief op die Ontwikkeling van die Maatskappy as Ondernemingsvorm, met Besondere Verwysing na die Posisie van Maatskappyskuldeisers en die Aanspreeklikheid van Direkteure Deel 1” (2002) 35 *De Jure* 236–352.

Lombard “’n Historiese Perspektief 2”

Lombard S “’n Historiese Perspektief op die Ontwikkeling van die Maatskappy as Ondernemingsvorm, met Besondere Verwysing na die Posisie van Maatskappyskuldeisers en die Aanspreeklikheid van Direkteure Deel 1” (2003) 36 *De Jure* 32–47.

Lombard “Importation of a Statutory Business Judgment Rule”

Lombard S “Importation of a Statutory Business Judgment Rule into South African Company Law: Yes or No?” (2005) 68 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 614–627.

Loubser “Does the King II Report Solve Anything?”

Loubser A “Does the King II Report Solve Anything?” (2001) 10 *Juta’s Business Law* 135–140.

Lowry “The Elasticity of Unfair prejudice”

Lowry J “The Elasticity of Unfair Prejudice: Stretching the Ambit of the Companies Act of 1985, s 459” (1995) *Lloyd’s Maritime and Commercial Law Quarterly* 337–342.

Lubbe “Die Toename in die Getal Belanghebbendes in Ondernemings”

Lubbe DS “Die Toename in die Getal Belanghebbendes in Ondernemings in die lig van die Sosiale Verantwoordelikheid van Ondernemings – ’n Ekonomiese Oorsig” (1995) 20 *Tydskrif vir Regswetenskap* 53–64.

Luiz “Extending the Liability of Directors”

Luiz S “Extending the Liability of Directors” (1988) 105 *South African Law Journal* 788–793.

Lumsden & Fridman “Corporate Social Responsibility”

Lumsden A, Fridman S “Corporate Social Responsibility: The Case for a Self-Regulatory Model” (2007) 25 *Company and Securities Law Journal* 147–179.

Lutter “The German System of Worker Participation”

Lutter M “The German System of Worker Participation in Practice” (1982) *Journal of Business Law* 154–161.

Mackenzie “The Employee and the Company Director”

Mackenzie, AL “The Employee and the Company Director” (1982) 132 *New Law Journal* 688–690.

Mackenzie “Directors’ Liability”

Mackenzie AC “Directors’ Liability - In Which Direction is South Africa Heading?” (1997) *Tydskrif vir die Suid Afrikaanse Reg* 370–379.

Mackenzie “Landmark Consumer Protection”

Mackenzie J “Landmark Consumer Protection Bill” (27 July 2006) available at www.mondaq.com/article (accessed 10 April 2007).

Mahoney “Contract or Concession”

Mahoney PG “Contract or Concession? An Essay on the History of Corporate Law” (2000) 34 *Georgia Law Review* 873–893.

McCabe “Are Corporations Socially Responsible”

McCabe B “Are Corporations Socially Responsible? Is Corporate Social Responsibility Desirable?” (1992) 4 *Bond Law Review* 1–20.

McConvill “Directors’ Duties to Stakeholders”

McConvill J “Directors’ Duties to Stakeholders” A Reform Proposal Based on Three False Assumptions” (2005) 18 *Australian Journal of Corporate Law* 88–102.

McCrystal “Shifting the Balance”

McCrystal S “Shifting the Balance of Power in Collective Bargaining: Australian Law, Industrial Action and Work Choices” (2006) 16 *The Economics and Labour Relations Review* 193.

McKenzie-Skene “Directors’ Duty to Creditors”

Mackenzie-Skene DW “The Directors’ Duty to the Creditors of a Financially Distressed Company: A Perspective from Across the Pond” (2007) 1 *Journal of Business & Technology Law* 499–528.

McLennan “Directors’ Duties”

McLennan JS “Directors’ Duties and Misapplication of Company Funds” (1982) 99 *South African Law Journal* 394–412.

McLennan “Duties of Care and Skill”

McLennan JS “Duties of Care and Skill of Company Directors and their Liability for Negligence” (1996) 8 *South African Mercantile Law Journal* 94–102.

Miles “Company Stakeholders”

Miles L “Company Stakeholders” (2003) 24 *The Company Lawyer* 56–59.

Macey & Miller “Corporate Stakeholders”

Macey JR, Miller GP “Corporate Stakeholders: A Contractual Perspective” (1993) 43 *University of Toronto Law Journal* 401–424.

Millon “Theories of the Corporation”

Millon D “Theories of the Corporation” (1990) April *Duke Law Journal* 201–262.

Mitchell et al. “Shareholder Value and Employee Interests”

Mitchell R, O’Donnell A & Ramsay I “Shareholder Value and Employee Interests: Intersections Between Corporate Governance, Corporate Law and Labor Law” (2005) 23 *Wisconsin International Law Journal* 417–476.

Mongalo “The Emergence of Corporate Governance”

Mongalo T “The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa” (2003) 120 *South African Law Journal* 173–191.

Mongalo “Self-Regulation versus Statutory Codification”

Mongalo T “Self-Regulation versus Statutory Codification: Should the New Regime of Corporate Governance be Accorded Statutory Backing” (2004) 67 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 264–279.

Mongalo “South Africanizing Company Law”

Mongalo T “South Africanizing Company Law for a Modern Competitive Global Economy” (2004) 121 *South African Law Journal* 93–116.

Nakajima “Enlightened Shareholder Value”

Nakajima C “Whither ‘Enlightened Shareholder Value’?” (2007) 28 *The Company Lawyer* 353–354.

Naudé “Section 36”

Naudé SJ “Company Contracts: The Effect of Section 36 of the New Age” (1974) 91 *South African Law Journal* 315–336.

Omar “The Company We Keep”

Omar PJ “The Company We Keep: Control over Access to the Incorporated Company form in the United Kingdom” (2007) 20 *Australian Journal of Corporate Law* 214–231.

O’Regan “Possibilities for Worker Participation”

O’Regan C “Possibilities for Worker Participation in Corporate Decision-making” (1990) *Acta Juridica* 113–132.

Pasban “The Business Judgment Rule”

Pasban MR et al. “Section 727 and the Business Judgment Rule: A Comparative Analysis of Company Directors’ Duties and Liabilities in English and United States law” (1997) 6 *Journal of Transnational Law and Policy* 201–221.

Pennington “Reports on Committees”

Pennington RR “Reports on Committees” (1962) 25 *Modern Law Review* 703–710.

Pettet “The Stirring of Corporate Social Conscience”

Pettet B “The Stirring of Corporate Social Conscience: From Cakes and Ale to Community Programmes ” (1997) 50 *Current Legal Problems* 279–314.

Pettet “The Combined Code”

Pettet B “The Combined Code: A Firm Place for Self-Regulation in Corporate Governance” (1998) 13 *The Company Lawyer* 394–400.

Pretorius “The Future of South African Company Law”

Pretorius JP “The Future of South African Company Law?” (2004) 12 *Juta’s Business Law* 66–74.

Proctor & Miles “Duty, Accountability and the Company Law Review” Proctor G, Miles L “Duty, Accountability and the Company Law Review” (1999) 20 *The Company Lawyer* 21–26.

Rademeyer & Holtzhausen “King II, Corporate Governance and Shareholder Activism”

Rademeyer C, Holtzhausen J “King II, Corporate Governance and Shareholder Activism” (2003) 120 *South African Law Journal* 767–776.

Ramsay “Corporate Theory”

Ramsay IM “Corporate Theory and Corporate Law Reform in Australia” (1994) 1 *Agenda* 179–188.

Ramsay “Law and Economics”

Ramsay IM “Law and Economics as an Approach to Corporate Law Research? A Commentary” (1996) 3 *Canberra Law Review* 48–53.

Ramsay & Hoad “Disclosure of Corporate Governance”

Ramsay IM, Hoad R “Disclosure of Corporate Governance Practices by Australian Companies” (1997) 15 *Company and Securities Law Journal* 454–470.

Ramsay et al. "Corporate Governance: The Perspective of Australian Institutional Shareholders"

Ramsay IM, Stapledon GP & Fong K "Corporate Governance: The Perspective of Australian Institutional Shareholders" (2000) 18 *Company and Securities Law Journal* 110–142.

Redmond "The Thrall of Shareholder Value"

Redmond P "The Thrall of Shareholder Value: Implications for CSR and Directors' Duties" (2006) March *Applied Corporate Governance* 79–83.

Reynolds "Employee Stakeholder Interests"

Reynolds A "Do Esops Strengthen Employee Stakeholder Interests?" (2001) 13 *Bond Law Review* 95–108.

Richardson "The Companies Act 2006"

Richardson G "The Companies Act 2006, Directors' Duties and the Onset of Insolvency" (2007) 23 *Insolvency Law & Practice* 138.

Rider "Percival"

Rider BAK "Percival v Wright – Per Incuriam" (1977) 40 *Modern Law Review* 471–476.

Riley "Directors' Duties and the Interests of Creditors"

Riley CA "Directors' Duties and the Interests of Creditors" (1989) 10 *The Company Lawyer* 87–93.

Riley "The Final Report of the Hampel Committee"

Riley CA "The Final Report of the Hampel Committee on Corporate Governance" (1998) 19 *The Company Lawyer* 179–180.

Roach “The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection”

Roach L “The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach” (2001) 22 *The Company Lawyer* 9–15.

Roach “The Legal Model of the Company”

Roach L “The Legal Model of the Company and the Company Law Review” (2005) 26 *The Company Lawyer* 98–103.

Roestoff & Renke “Debt Relief for Consumers (1)”

Roestoff M, Renke S “Debt Relief for Consumers – The Interaction between Insolvency and Consumer Protection Legislation (Part 1)” (2005) 26 *Obiter* 561–574.

Rose “A State of Mind”

Rose R “A State of Mind” *Financial Mail Governance* (2007) (19 July) available at <http://blogs.fm.co.za/governance/2007/07/19/a-state-of-mind/> (accessed 10 May 2008).

Rosenfeld “A Pluralist Critique”

Rosenfeld M “A Pluralist Critique of Contractarian Proceduralism” (1998) 11 *Ratio Juris* 291–319.

Sarre “Responding to Corporate Collapses”

Sarre R “Responding to Corporate Collapses: Is There a Role for Corporate Social Responsibility” (2002) 7 *Deakin Law Review* 1–19.

Schall et al. “Promoting an Inclusive Approach”

Schall A, Miles L & Goulding S “Promoting an Inclusive Approach on the Part of Directors: The UK and German Positions” (2006) 6 *Journal of Corporate Law Studies* 299–327.

Sealy “Directors’ Duties”

Sealy LS “Directors’ Duties — An Unnecessary Gloss” (1988) 47 *Cambridge Law Journal* 175–177.

Sealy “Directors’ Wider Responsibilities”

Sealy LS “Directors’ Wider Responsibilities – Problems Conceptual, Practical and Procedural” (1987) 13 *Monash University Law Review* 164–188.

Sealy “The Director as Trustee”

Sealy LS “The Director as Trustee” (1967) 25 *Cambridge Law Journal* 83–103.

Shandu “Shareholders’ Interests”

Shandu S “Shareholders’ Interests versus Social Demands: Incongruous Agendas” (2005) 26 *Obiter* 87–99.

Sheehy “The Importance of Corporate Models”

Sheehy B “The Importance of Corporate Models: Economic and Jurisprudential Values and the Future of Corporate Law” (2003–2004) 2 *DePaul Business & Commercial Law Journal* 463–513.

Sheehy “The Reluctant Stakeholder”

Sheehy B “Scrooge – The Reluctant Stakeholder: Theoretical Problems in the Shareholder–Stakeholder Debate” (2005) 14 *University of Miami Business Law Review* 193–240.

Sheikh “Introduction to the Corporate Governance Themed Issues”

Sheikh S “Introduction to the Corporate Governance Themed Issues” (1998) 9 *International Company and Commercial Law Review* 267–274.

Sheikh “Company Law Reform”

Sheikh S “Company Law Reform: Part 1” (2006) 17 *International Company and Commercial Law Review* 13–21.

Sher “Piercing the Corporate Veil”

Sher H “Piercing the Corporate Veil: The Independent Legal Personality of Companies” (1996) 4 *Juta’s Business Law* 51–54.

Siems “Shareholders, Stakeholders”

Siems MM “Shareholders, Stakeholders and the Ordoliberalism” (2002) 13 *European Business Law Review* 147–159.

Slaughter “Corporate Social Responsibility”

Slaughter “Corporate Social Responsibility: A New Perspective” (1997) 18 *Company Lawyer* 313–329.

Spisto “Stakeholder Interests in Corporate Governance”

Spisto M “Stakeholder Interests in Corporate Governance: Is a New Model of Governance a Change for the Better for South Africa? – Part 1” (2005) 18 *Australian Journal of Corporate Law* 129–147.

Spisto “The Significance of the King Reports”

Spisto M “The Significance of the King Reports and the Department of Trade and Industry's Policy Statements on South Africa's Corporate Law and Worker Participation Reform Programmes – Part 2” (2005) 18 *Australian Journal of Corporate Law* 304–341.

Steenkamp et al. “The Right to Bargain”

Steenkamp A, Stelzner S & Badenhorst N “The Right to Bargain Collectively” (2006) 25 *Industrial Law Journal* 943–961.

Sternberg “Stakeholder Theory”

Sternberg E “The Defects of Stakeholder Theory” (1997) 5 *Corporate Governance* 3–10.

Symes “A New Statutory Directors’ Duty”

Symes CF “A New Statutory Directors’ Duty for Australia – A ‘Duty’ to be Concerned About Employee Entitlements in the Insolvent Corporation” (2003) 12 *International Insolvency Review* 133–145.

Van der Linde “A Wake-up Call”

Van der Linde K “A Wake-up Call for Close Corporation Members” (2002) 10 *Juta’s Business Law* 2–4.

Van der Merwe “Die Beskerming van Minderheidsaandeelhouders”

Van der Merwe BA “Die Beskerming van Minderheidsaandeelhouders: Die Toepassingsgebied van die Reël in *Foss v Harbottle* Uitgebrei?” (1993) *South African Mercantile Law Journal* 216.

Velasco “The Rights of the Shareholder”

Velasco J “The Fundamental Rights of the Shareholder” (2006) 40 *University of California Davis Law Review* 407–467.

Villiers “Draft Report by the Cadbury Committee”

Villiers C “Draft Report by the Cadbury Committee on the Financial Aspects of Corporate Governance” (1992) 13 *The Company Lawyer* 214–217.

Von Nessen “Corporate Governance in Australia”

Von Nessen P “Corporate Governance in Australia: Converging with International Developments” (2003) 15 *Australian Journal of Corporate Law* 189–224.

Watson “Directors’ Duties”

Watson SM “Directors’ Duties in New Zealand” (1998) September *Journal of Business Law* 495–514.

Webberburn “The Social Responsibility of Corporations”

Lord Wedderburn “The Social Responsibility of Corporations” (1985) 15 *Melbourne University Law Review* 4–30.

Wesley-Key “Companies Act 2006”

Wesley-Key S “Companies Act 2006: Are Cracks Showing in the Glass Ceiling” (2007) 18 *International Company and Commercial Law Review* 422–429.

Whincop “The Modern Reformulation of Directors’ Duties of Care”

Whincop MJ “A Theoretical and Policy Critique of the Modern Reformulation of Directors’ Duties of Care” (1996) 6 *Australian Journal of Corporate Law* 72–92.

Williams “Corporate Social Responsibility”

Williams CA “Corporate Social Responsibility in an Era of Economic Globalization” (2002) 35 *University of California Davis Law Review* 705–777.

Williamson “Transaction-Cost Economics”

Williamson OE “Transaction-Cost Economics: The Governance of Contractual Relations” (1979) 22 *Journal of Law and Economics* 233–261.

Williamson “Corporate Governance”

Williamson OE “Corporate Governance” (1984) 93 *The Yale Law Journal* 1197–1230.

Wishart “Models and Theories”

Wishart DA “Models and Theories of Directors’ Duties to Creditors” (1991) 14 *New Zealand Universities Law Review* 323–354.

Woker “Business Practices and the Consumer Affairs Act”

Woker T “Business Practices and the Consumer Affairs (Harmful Business Practices) Act 71 of 1988” (2001) 13 *South African Mercantile Law Journal* 315–323.

Wood “Whom Should Business Serve?”

Wood D “Whom Should Business Serve?” (2002) 14 *Australian Journal of Corporate Law* 266–285.

Wooden “Industrial Relations Reform”

Wooden M “Industrial Relations Reform in Australia: Causes, Consequences and Prospects” (2001) 34 *The Australian Economic Review* 243–262.

Wynn-Evans “The Companies Act 2006 and the Interests of Employees”

Wynn-Evans C “The Companies Act 2006 and the Interests of Employees” (2007) 36
Industrial Law Journal 188–193.

Yavasi “Corporate Governance Problems in the EU”

Yavasi M “A Socio-legal and Economic Introduction to Corporate Governance
Problems in the EU” (2001) 22 *The Company Lawyer* 162–170.

Younghusband “Corporate Governance in the United Kingdom”

Younghusband V “Corporate Governance in the United Kingdom” (1998) 9
International Company and Commercial Law Review 275–280.

BOOKS AND THESES

Abernethy & Weir *Anderson's Company & Securities Law*

Abernethy E, Weir RGB *Anderson's Company & Securities Law Directors' Responsibilities under the Companies Act 1993* (1994) Brooker's

Alcock et al. *Companies Act 2006*

Alcock A, Birds J & Gale S *Companies Act 2006* (2007) Jordans.

Anderson *Corporate Directors' Liability*

Anderson H *Corporate Directors' Liability to Creditors* (2007) Thomson.

Andriof & McIntosh *Perspectives on Corporate Citizenship*

Andriof J, McIntosh M (eds) *Perspectives on Corporate Citizenship* (2001) Greenleaf Publishing.

Austin et al. *Company Directors*

Austin RP, Ford HAJ & Ramsay IM *Company Directors: Principles of Law and Corporate Governance* (2005) LexisNexis Butterworths.

Baxt et al. *Corporations*

Baxt R, Fletcher K & Fridman S *Corporations and Associations Cases and Materials* 9ed (2003) Lexis Nexis Butterworths.

Berle & Means *The Modern Corporation and Private Property*

Berle AA, Means GC *The Modern Corporation and Private Property* (1968) Harcourt, Brace and World, Inc.

Berns & Baron *Company Law and Governance*

Berns S, Baron P *Company Law and Corporate Governance: An Australian Perspective* (1998) Oxford UP.

Beuthin & Luiz *Company Law*

Beuthin RC, Luiz SM *Beuthin's Basic Company Law* 3ed (2000) Butterworths.

Birds et al. *Boyle & Birds' Company Law*

Birds J, Boyle AJ, MacNeil I, McCormack G, Twigg-Flesner C & Villiers C (eds) *Boyle & Birds' Company Law* 5ed (2004) Jordans.

Birds "The Reform of Directors' Duties"

Birds J "The Reform of Directors' Duties" in *The Reform of United Kingdom Company Law* (2002) De Lacy J (ed) Cavendish Publishing London 149–178.

Blackman et al. *Commentary on the Companies Act*

Blackman MS, Jooste RD & Everingham GK *Commentary on the Companies Act* Volumes 1, 2, 3 (2002) Juta.

Blair *Ownership and Control*

Blair MM *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (1995) The Brookings Institute.

Cassidy *Corporations Law*

Cassidy J *Concise Corporations Law* 3ed (2001) The Federation Press.

Chandler "The Managerial Revolution"

Chandler AD "The Managerial Revolution in American Business" in *The Visible Hand* (1977) Cambridge, Mass Havard University.

Morse et al. *Charlesworth's Company Law*

Morse G, Girvin S, Morris R, Frisby S & Hodson A *Charlesworth Company Law* 17ed (2005) London: Sweet & Maxwell.

Cheffins *Company Law*

Cheffins BR *Company Law: Theory, Structure and Operation* (1998) Clarendon Press.

Chew & Gillan *Corporate Governance*

Chew DH, Gillan SL (eds) *Corporate Governance at the Crossroads: A Book of Readings* (2005) McGraw-Hill.

Cilliers & Benade *Corporate Law*

Cilliers HS, Benade ML (eds) *Corporate Law* 3ed (2000) Butterworths.

Clarke *Theories of Corporate Governance*

Clarke T (ed) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* (2004) Routledge.

Clarke & Glegg *Changing Paradigms*

Clarke T, Glegg S *Changing Paradigms: The Transformation of Management Knowledge for the 21 st Century* (2000) HarperCollins Business.

Collins et al. *Legal Regulation*

Collins H, Davies P & Rideout RW *Legal Regulation of the Employment Relation* (2000) Kluwer Law International.

Crowther & Rayman-Bacchus *Perspectives on Corporate Social Responsibility*

Crowther D, Rayman-Bacchus L (eds) *Perspectives on Corporate Social Responsibility* (2004) Ashgate.

David & Brierley *Major Legal Systems in the World*

David R & Brierley JEC *Major Legal Systems in the World* (1985) Stevens.

Davies A *Strategic Approach to Corporate Governance*

Davies A A *Strategic Approach to Corporate Governance* (1999) Gower.

Davies *Gower and Davies' Principles of Modern Company Law*

Davies PL *Gower and Davies' Principles of Modern Company Law* 7ed (2003) Sweet & Maxwell.

Davies *Introduction to Company Law*

Davies PL *Introduction to Company Law* (2002) Oxford UP.

Davies & Freedland *Kahn-Freund's Labour and the Law*

Davies P, Freedland P *Kahn-Freund's Labour and the Law* (1983) London, Stevens and Sons.

Deakin & Morris *Labour Law*

Deakin S, Morris G *Labour Law* 4ed Hart Publishing.

Deakin *The Contract of Employment*

Deakin S Working Paper No 203: *The Contract of Employment* (2005) ESRC Centre for Business Research, University of Cambridge.

De Cruz *Comparative Law*

De Cruz P *Comparative Law in a Changing World* 2ed (1999) Cavendish Publishing Limited.

De Lacy *The Reform of United Kingdom Company Law*

De Lacy J (ed) *The Reform of United Kingdom Company Law* (2002) Cavendish.

Lowry & Dignam *Company Law*

Lowry JP, Dignam AJ *Company Law* (2003) LexisNexis.

Dine & Koutsias *Company Law*

Dine J, Koutsias M *Company Law* 6ed (2007) Macmillan.

Du Plessis et al. *Principles of Contemporary Corporate Governance*

Du Plessis JJ, McConvill J & Bagaric M *Principles of Contemporary Corporate Governance* (2005) Cambridge UP.

Du Plessis et al. *German Corporate Governance*

Du Plessis JJ, Großfeld B, Lutterman C, Saenger I & Sandrock O *German Corporate Governance in International and European Context* (2007) Springer.

Du Toit et al. *Labour Relations Law*

Du Toit D, Bosch D & Woolfrey D *Labour Relations Law: A Comprehensive Guide* 5ed (2006) LexisNexis Butterworths.

Eilís *Progress Report*

Eilís F *The Company Law Reform in the United Kingdom: A Progress Report* (2005) Mohr Siebeck.

Farrar & Hannigan *Company Law*

Farrar JH, Hannigan BM *Farrar's Company Law* 4ed (1998) Butterworths.

Farrar *Corporate Governance*

Farrar JH *Corporate Governance: Theories, Principles, and Practice* 2ed (2005)
Oxford UP.

Finn *Fiduciary Obligations*

Finn PD *Fiduciary Obligations* (1977) Sydney: Law Book Co.

Freedman "Reforming Company Law"

Freedman J "Reforming Company Law" in *Perspectives on Company Law: 1* (1995)
Patfield FM (ed) Kluwer Law International 197–221.

Freemantle & Rocky *The Good Corporate Citizen*

Freemantle A, Rockey N *The Good Corporate Citizen: Pursuing Sustainable
Business in South Africa* (2004) Trialogue.

Friedman *Capitalism and Freedom*

Friedman M *Capitalism and Freedom* (1962) University of Chicago Press.

Ford et al. *Ford's Principles of Corporations Law*

Ford H, Austin JR & Ramsay I *Ford's Principles of Corporations Law* 13 ed (2007)
Butterworths.

Giraldo *The Business Judgment Rule*

Giraldo CAL *Factors Governing the Application of the Business Judgment Rule: An
Empirical Study of the US, UK, Australia and the EU* (2004–2005) Erasmus
University Rotterdam, The Netherlands.

Grogan *Workplace Law*

Grogan J *Workplace Law* 9ed (2007) Juta.

Hahlo & Farrar *Cases and Materials*

Hahlo HR, Farrar JH *Hahlo's Cases and Materials on Company Law* 3ed (1987)
London Sweet & Maxwell.

Hannigan *Company Law*

Hannigan B *Company Law* (2003) LexisNexis.

Havenga *Fiduciary Duties of Company Directors*

Havenga MK *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (1998) UOFS 29 Transactions Centre for Business Law.

Havenga et al. *Commercial Law*

Havenga P, Havenga MK, Kelbrick R, McGregor M, Schulze H & van der Linde K *General Principles of Commercial Law* 6ed (2007) Juta.

Henochsberg *Commentary on the Companies Act*

PM Meskin, JA Kunst, BA Galgut, PA Delport & Q Vorster *Commentary on the Companies Act* (last updated: September 2007).

Hockly et al. *Insolvency Law*

Hockly HE, Sharrock R, van der Linde K & Smith A *Hockly's Insolvency Law* 8ed (2007) Juta.

Keenan & Bisacre *Company Law*

Keenan D, Bisacre J *Smith and Keenan's Company Law with Scottish Supplement* 13ed Pearson Longman.

Keenan & Riches *Business Law*

Keenan D, Riches S *Business Law* 8ed Pearson Longman.

Keller "Employment Relations in Germany" in Bamber et al. *International and Comparative Employment Relations*.

Keller BK "Employment Relations in Germany" in Bamber GJ, Lansbury RD, Wailes N (eds) *International and Comparative Employment Relations* 4ed (2004) SAGE.

Kiggundu *Botswana Company Law*

Kiggundu J *Botswana Company Law Service* (2005) Juta.

Kiggundu "Botswana"

Kiggundu J "Botswana" in Blanpain R (ed) *International Encyclopaedia of Laws (Botswana)* (1997) Kluwer Law International.

Ellis "Evidence" in LAWSA

Ellis I *Evidence* in Joubert WA (gen ed) *The Law of South Africa* volume 3(2) paragraph 73 accessed via Lexis Nexis Butterworths Online.

Schmidt et al. “Civil Procedure” in *LAWSA*

Schmidt CHW, Zeffertt DT & Van Der Merwe DP *Civil Procedure: Magistrates’ Courts* in Joubert WA (gen ed) *The Law of South Africa* volume 9 paragraph 751 accessed via Lexis Nexis Butterworths Online.

Learmount “Theorising Corporate Governance”

Learmount S “Theorising Corporate Governance: New Organisational Alternatives” (2002) ESRC Centre for Business Research University of Cambridge Working Paper 237.

Lombard *Directors’ Duties to Creditors*

Lombard S *Directors’ Duties to Creditors* (2006) University of Pretoria.

Luiz *The South African Securities Regulation Code*

Luiz SM *An Evaluation of the South African Securities Regulation Code on Takeovers and Mergers* (2003) Unpublished LLD Thesis (Unisa).

Macintyre & Mitchell *Foundations of Arbitration*

Macintyre S, Mitchell T (eds) *Foundations of Arbitration* (1989)

Mallin *Corporate Governance*

Mallin CA *Corporate Governance* (2004) Oxford UP.

Mayson et al. *Company Law*

French D, Mayson SW & Ryan CL *Mayson, French & Ryan on Company Law* 24ed (2007–2008) Oxford UP.

McBarnet et al. “: Corporate Social Responsibility”

McBarnet D, Voiculescu A & Campbell T (eds) “The New Corporate Accountability: Corporate Social Responsibility Beyond Law, Through Law, for Law” in *The New Corporate Accountability: Corporate Social Responsibility and the Law* (2007) Cambridge University Press.

Monks *Corporate Governance*

Monks RAG *Corporate Governance* (1995) Blackwell Publishers.

Morison *Morisons' Company Law New Zealand*

Morison CB *Morisons' Company Law New Zealand* (2007) LexisNexis.

Naudé *Die Regsposisie van die Maatskappydirekteur*

Naudé SJ *Die Regsposisie van die Maatskappdirekteur met Besondere Verwysing van die Interne Maatskappyverband* (1970) Butterworths.

Otto *The National Credit Act Explained*

Otto JM *The National Credit Act Explained* (2006) LexisNexis Butterworths.

Parkinson *Corporate Power*

Parkinson JE *Corporate Power and Responsibility Issues in the Theory of Company Law* (1993) Clarendon Press Oxford.

Pennington *Company Law*

Pennington RR *Company Law* 8ed (2001) Butterworths.

Penrose *Theory of the Growth of the Firm*

Penrose ET *Theory of the Growth of the Firm* 3ed (1995) Oxford UP.

Pettet *Company Law*

Pettet BG *Company Law* 2ed (2005) Pearson Longman.

Redmond "Safe Harbour or Sleepy Hollows"

Redmond P "Safe Harbour or Sleepy Hollows" in *Corporate Governance and the Duties of Directors* (1997) Melbourne University, Centre for Corporate Law & Securities Regulation.

Redmond *Companies and Securities Law*

Redmond P *Companies and Securities Law* 3ed (2000) LBC Information Series.

Reyburn & Sutherland *Competition Law of South Africa* (December 2006)

Reyburn L & Sutherland P *Competition Law of South Africa* (December 2006) Lexis Nexis Butterworths.

Rickford "A History of the Company Law Review"

Rickford J “A History of the Company Law Review” in *The Reform of United Kingdom Company Law* (2002) De Lacy J (ed) Cavendish 3–37.

Sealy *Cases and Materials*

Sealy LS *Cases and Materials in Company Law* 7ed (2001) Butterworths.

Smerdon A *Practical Guide to Corporate Governance*

Smerdon R A *Practical Guide to Corporate Governance* 2ed (2004) London Sweet & Maxwell.

Stapledon *Institutional Shareholders and Corporate Governance*

Stapledon GP *Institutional Shareholders and Corporate Governance* (1996) Clarendon Press.

Van der Merwe *Kontraktereg*

Van der Merwe S *Kontraktereg: Algemene Beginsels* 2ed (2004) Juta.

Vettori *Alternative Means to Regulate the Employment Relationship*

Vettori M-S *Alternative Means to Regulate the Employment Relationship in the Changing World of Work* (2005) University of Pretoria

Volhard & Arndt *German Limited Liability Company (GmbH)*

Volhard E, Arndt S *German Limited Liability Company (GmbH)* (1997) John Wiley.

Wheeler & Sillanpää *The Stakeholder Corporation*

Wheeler D, Sillanpää M *The Stakeholder Corporation: A Blueprint for Stakeholder Value* (1997) Pitman Publishing.

Whincop *An Economic and Jurisprudential Genealogy*

Whincop MJ *An Economic and Jurisprudential Genealogy of Corporate Law* (2001) Ashgate.

Wixley & Everingham *Corporate Governance*

Wixley T, Everingham G *Corporate Governance* 2ed (2005) Siber Ink.

Worthington “The Duty to Monitor”

Worthington S “The Duty to Monitor: A Modern View of the Directors’ Duty of Care” in *Perspectives on Company Law: 2* (1997) Patfield FM (ed) Kluwer Law International 181–202.

Zweigert & Kötz *An Introduction to Comparative Law*

Zweigert K & Kötz H *An Introduction to Comparative Law* 2ed (1992) Clarendon Paperbacks.

TABLE OF STATUTES, CODES AND BILLS

AUSTRALIA

Australian Securities and Investments Commission Act No 51 of 2001.....	133
Australian Uniform Companies Act of 1961	191
Close Corporations Act of 1989	129
Corporate Law Economic Reform Programme Audit Reform and Corporate Disclosure Act 103 of 2004	127
Corporate Law Economic Reform Program Act 156 of 1999	169
Corporations Act 50 of 2001	127, 132ff, 137, 140, 141, 145, 153, 155, 163, 173, 176, 178ff, 311
Corporations Act of 1989	129
Corporations Law Amendment (Employee Entitlements) Act of 2000 ...	145, 152, 156
Corporations Legislation Amendment Act 110 of 1990.....	129
Financial Services Reform Act of 2001.....	169
Mining Companies Act 1871 (Vic)	128
Australian Securities Act of 1989	129
Trade Practices Act 51 of 1974.....	157, 158, 159, 312
Workplace Relations Act 86 of 1996.....	148, 150, 151, 156
Workplace Relations Amendment Act (Work Choices) 153 of 2005	151, 152, 156

BOTSWANA

Companies (Amendment) Act 7 of 1995.....	188, 194
Companies (Amendment) Act 8 of 1961	188
Companies Act 32 of 2004	16, 193, 196ff
Companies Act of 1959 (Cap 42:01)	188, 190, 194ff
Laws of Bechuanaland Protectorate, Proclamation 71 of 1959.....	188

GERMANY

<i>Betriebsverfassungsgesetz</i> of 1972	247
Corporate Governance Code for Listed German Corporations (2002).....	14, 240,

248ff

German Commercial Code 1861	240, 242
<i>Mitbestimmungsgesetz</i> of 1976.....	243ff
<i>Montan-Mitbestimmungsgesetz</i> of 1951	252
One Third Participation Act / <i>Drittelbeteiligungsgesetz</i> of 2004	244
Stock Corporation Act / <i>Aktiengesetz</i> of 1965	241
Works Constitution Act of 1920.....	243
Works Constitution Act of 1952.....	244
Works Constitution Act of 1972.....	247

MAURITIUS

Mauritius Companies Act 57 of 1984.....	192
---	-----

NEW ZEALAND

New Zealand Companies Act 105 of 1993.....	16, 192, 193, 196, 198
--	------------------------

RHODESIA

Companies (Southern Rhodesia) Amendment Act 20 of 1959.....	188
---	-----

SOUTH AFRICA

Basic Conditions of Employment Act 75 of 1997	258
Broad Based Black Economic Empowerment Act 53 of 2003.....	8, 11, 206, 208
Close Corporations Act 69 of 1984	12, 129, 205, 206, 223
Companies Act 46 of 1926	12, 188
Companies Act 61 of 1973	12, 31, 62, 204, 205, 210, 220, 300
Companies Amendment Act 23 of 1939.....	12
Companies Amendment Act 46 of 1952.....	12
Competition Act 89 of 1998	206, 267, 275
Constitution of the Republic of South Africa, 1996.....	4, 11, 205, 285, 286, 315
Consumer Affairs (Unfair Business Practices) Act 71 of 1988.....	266, 268, 269
Consumer Protection Bill 2007.....	272ff, 300, 323
Draft Companies Bill of 2007..	11, 13, 16, 23, 31, 34, 38, 49, 201, 203, 207, 253, 277, 288ff, 301, 304, 308, 313ff, 316

Draft Consumer Protection Bill 2006	273ff
Employment Equity Act 55 of 1998	258
Estate Agency Affairs Act 112 of 1976.....	267ff
Harmful Business Practices Amendment Act 23 of 1999	268
Insolvency Act 24 of 1936.....	224ff
Labour Relations Act 66 of 1995.....	8, 11, 37, 208, 257ff
National Credit Act 34 of 2005.....	269ff, 275
Promotion of Access to Information Act 2 of 2000.....	11, 206, 208, 262, 286
Reporting by Public Entities Act 93 of 1992	294

SWAZILAND

Companies and Associations Act 7 of 1912 (Swaziland).....	182, 187
---	----------

UNITED KINGDOM

Bubble Act 6 Geo 1, c 18.....	43, 45ff
Companies Act of 1862	46
Companies Act of 1948	46, 188, 191, 192, 194
Companies Act of 1981	48
Companies Act of 1985	12, 42, 46, 48, 53, 63, 75, 89, 96, 97, 102, 104, 107, 108, 113, 121, 153, 200, 238
Companies Act of 2006	10, 15, 42, 43, 49ff, 63, 89, 110ff, 121, 201, 203, 238, 292, 303, 308ff
Company Directors Disqualification Act of 1986	48, 68, 71
Company Law Reform Bill 190 of 2006	88, 89, 106
Competition Act of 1998	66
Consumer Credit Act of 2006.....	66ff
Directors' Liability Act of 1890	46
Employment Relations Act of 1999	64, 310
Enterprise Act of 2002	66ff, 310
Fair Trading Act of 1973	65, 67, 310
Insolvency Act of 1986.....	61, 71, 72, 115, 119, 310
Joint Stock Exchange Companies Limited Liabilities Act 23 of 1861	12
Unfair Contract Terms Act of 1977	66, 69

TABLE OF CASES

AUSTRALIA

<i>ASC v Gallagher</i> (1993) 11 ACLC 286.....	162
<i>Ascot Investments Pty Ltd v Harper</i> (1981) 148 CLR 337 (HC).....	138
<i>ASIC v Loiterta</i> (2004) 50 ACSR 693	163
<i>ASIC v Rich</i> (2003) 44 ACSR 341.....	163
<i>ASIC v Vines</i> (2005) 55 ACSR 617	163
<i>Australian Innovation Ltd v Petrovsky</i> (1996) 21 ACSR 218	141
<i>Australian Metropolitan Life Assurance Co Ltd v Ure</i> (1923) 33 CLR 199 (HC).....	
.....	136, 138
<i>Australian Securities Commission v As Nominees Ltd</i> (1995) 62 FCR 504.....	163
<i>AWA Ltd v Daniels (t/a Deloitte Haskins & Sells)</i> (1992) 10 ACLC 933	130, 162
<i>Brunninghausen v Glavanics</i> (1999) 17 ACLC 1247.....	142
<i>Capital Investments Corporations Pty Ltd v Classic Trading Pty Ltd</i> (unreported)	
Federal Court, 28 September 2001	139
<i>Chan v Zacharia</i> (1984) 154 CLR 178.....	138
<i>Daniels v Anderson</i> (1995) 13 ACLC 614.....	162, 163
<i>Darvall v North Sydney Brick and Tile Co</i> (1988) 6 ACLC 154.....	137, 138, 141
<i>Davidson v Smith</i> (1989) 15 ACLR 732.....	138
<i>Deputy Commissioner of Taxation v Clark</i> (2003) 45 ACSR 332	163
<i>Emlen Pty Ltd v St Barbara Mines Ltd</i> (1997) 24 ACSR 303.....	137, 138
<i>Fitzroy Football Club Ltd v Bondborough (Pty) Ltd</i> (1997) 15 ACLC 638.....	142
<i>Fitzsimmons v R</i> (1997) 23 ACSR 355.....	161
<i>Forge v ASIC</i> (2004) 213 ALR 574 (CA)	163
<i>Fulham Football Club v Cabra Estates plc</i> [1992] BCC 863	138
<i>Furs Ltd v Tomkies</i> (1936) 54 CLR 583	139
<i>Gamble v Hoffman</i> (1997) 24 ACSR 369.....	162
<i>Grove v Flavel</i> (1986) 11 ACLR 161	144
<i>Hospital Products Ltd v United States Surgical Corporation</i> (1984) 156 CLR 41	
(HC)	136, 138

<i>Hurley v NCSC</i> (1993) 11 ACLC 443	162
<i>Jeffree v National Companies & Securities Commission</i> (1989) 15 ACLR 217	
.....	58, 144, 229
<i>Jenkins v Enterprise Gold Mines NL</i> (1992) 6 ACSR 539	139
<i>Keith Henry & Co Pty v Stuart Walker & Co Pty</i> [1958] CLR 342	54
<i>Kinsela v Russell Kinsela Pty Ltd (in liq)</i> (1986) 10 ACLR 395	58, 60, 143, 145,
230, 232, 233	
<i>Marson (Pty) Ltd v Pressbank (Pty) Ltd</i> (1987) ACLC 338	161
<i>Mesenberg v Cord Industrial Recruiters Pty Ltd</i> (1996) ACLC 519	142
<i>Mills v Mills</i> (1938) 60 CLR 150 (HC)	132, 136
<i>NRMA v Geeson</i> (2001) 39 ACSR 401	141
<i>NRMA v Geeson</i> (2001) 40 ACSR 1	141
<i>New World Alliance (Pty) Ltd; Sycotex (Pty) Ltd v Baseler</i> (1994) 51 FCR 425	
.....	142, 144
<i>News Ltd v Australian Rugby League Ltd</i> (1996) 21 ACSR 635	136
<i>Ngurli v McCann</i> (1953) 90 CLR 425 (HCA)	141
<i>NSW v Commonwealth</i> (1990) 8 ACLC 120	129
<i>Paul A Davies (Australia) Pty Ltd v Davies & Sons</i> (1984) 8 ACLR 1	139
<i>Permanent Building Society (in liq) v McGee</i> (1993) 11 ACSR 260	134, 139, 161
<i>Permanent Building Society (in liq) v Wheeler</i> (1994) 14 ACSR 109	137
<i>Provident International Corporation v International Leasing Corp Ltd</i> [1969] 1	
NSWR 424	142
<i>R v Byrnes, R v Hopwood</i> (1995) 17 ACSR 551	140
<i>Re HIH Insurance Ltd (in liq) v Adler</i> (2002) 41 ACSR 72	164
<i>Re One.Tel Ltd (in Liq); ASIC v Rich</i> (2003) 44 ACSR 682	163
<i>Ring v Sutton</i> (1980) 5 ACLR 546	58, 143, 229, 230
<i>South Australia v Marcus Clark</i> (1996) 19 ACSR 606	162
<i>Spies v The Queen</i> (2000) 201 CLR 603 (HC)	58, 144, 145, 229
<i>Thorby v Goldberg</i> (1964) 112 CLR 597 (HCA)	138
<i>Vrisakis v ASC</i> (1993) 11 ACLC 763	162
<i>Walker v Wimborne</i> (1976) 137 CLR 1 (HC)	58, 60, 143, 144, 145, 146, 229
<i>Warman International Ltd v Dwyer</i> (1995) 69 ALJR 362	139
<i>Whitehouse v Carlton Hotel Pty Ltd</i> (1987) 162 CLR 285 (HCA)	109, 137, 141
<i>Wilkinson v Feldworth Financial Services Pty Ltd</i> (1998) 29 ACSR 642	163

CANADA

<i>Brant Investments Ltd v KeepRite Inc</i> (1988) 80 DLR 16	51
<i>Gray v New Augarita Porcupine Mines Ltd</i> (1952) 3 DLR 1	53
<i>People's Department Stores Inc v Wise</i> (2004) 244 DLR 564	141
<i>Teck Corporation Ltd v Millar</i> (1973) 33 DLR 288	141

ENGLAND

<i>Aberdeen Rail Co v Blaikie Bros</i> (1854) 1 Macq 461	54
<i>Allen v Hyatt</i> (1914) 30 TLR 444 (PC)	57, 194, 214
<i>Allied Carpets Group plc v Nethercott</i> [2001] BCC 81	53
<i>Aron Salomon v A Salomon & Co Ltd</i> [1897] AC 22 (HL)	35, 217
<i>Automatic Self-Cleansing Filter Syndicate v Cunninghame</i> (1906) 2 Ch 34 (CA) 207	237
<i>Base Metal Trading Ltd v Shamurin</i> (2004) EWCA Civ 1316	70
<i>Bentinck v Thomas Fenn</i> (1887) 12 App Cas 652 (HL)	53
<i>Boardman v Phipps</i> [1967] 2 AC 46 (HL)	54, 138, 140
<i>Boston Deep Sea Fishing and Ice Cold Ltd v Ansell</i> (1888) LR 9 Eq 480	54
<i>Brady v Brady</i> (1987) 3 BCC 535 (CA)	59, 60
<i>Briess v Woolley</i> [1954] AC 333 (HL)	214
<i>Bristol and West Building Society v Mothew</i> (1998) Ch 1 (CA)	70
<i>Charterbridge Corporation Ltd v Lloyds Bank Ltd</i> (1970) Ch 62	51, 62, 140
<i>Clark v Workman</i> (1920) 1 IR 107	101
<i>CMS Dolphin Ltd v Simonet</i> [2001] 2 BCLC 704	54
<i>Cook v GC Deeks</i> [1916] 1 AC 554 (PC)	195
<i>Dawson International plc v Coat Paton plc</i> (1988) SLT 854	216
<i>Dorchester Finance Co Ltd v Stebbing</i> (1989) BCLC 498 (Ch)	70, 71, 276
<i>Freeman and Lockyer v Buckhurst Properties (Mangal) Ltd</i> [1964] 2 QB 480 (CA)	109
<i>Gaiman v National Association for Mental Health</i> [1971] Ch 317	56
<i>Galloway v Halle Concerts Society</i> (1915) 2 Ch 233	212
<i>Gencor ACP Ltd v Dalby</i> (2000) 2 BCLC 734 (Ch)	54
<i>Geneva Finance Ltd (rec and mgr apptd) v Resources Industries Ltd</i> (2002) ACLC 1427	141

<i>George Bray v John Rawlinson Ford</i> [1896] AC 44 (HL)	139
<i>Gething v Kilner</i> [1972] 1 WLR 337	215
<i>Greenhalgh v Arderne Cinemas</i> [1951] Ch 286	141
<i>Hampson v Price's Patent Candle Company</i> (1876) 45 LJ Ch 437	62, 122
<i>Hely-Hutchinson v Brayhead Ltd</i> (1968) 1 QB 3 All ER 98 (CA).....	53, 109
<i>Heron International Ltd v Lord Grade, Associated Communications Corp plc</i> [1983] BCLC 244 (CA).....	56
<i>Hickman v Kent or Romney Marsh Sheep Breeders' Association</i> [1915] 1 Ch 881 ..	37
<i>Hindle v John Cotton Ltd</i> (1919) 56 SLR 625	109
<i>Hogg v Cramphorn Ltd</i> [1967] Ch 254	52
<i>Howard Smith Ltd v Ampol Petroleum Ltd</i> [1974] AC 821 (PC).....	51, 52, 104, 133, 137
<i>Hutton v West Cork Railway Company</i> (1883) 23 ChD 654 (CA).....	61, 62, 122, 234, 284
<i>In Re Exchange Banking Company</i> (1882) 21 Ch D 519 (CA)	53
<i>Industrial Development Consultants Ltd v Cooley</i> (1972) 1 WLR 443	54, 210
<i>Island Export Finance Ltd v Umunna</i> [1986] BCLC 460	54
<i>Item Software (UK) Ltd v Fassihi</i> (2004) EWCA Civ 1244 (CA).....	51
<i>JJ Harrison (Pty) Ltd v Harrison</i> (2001) EWCA Civ 1467 (CA)	51
<i>John Shaw and Sons (Salford) Ltd v Shaw</i> (1935) 2 KB 113 (CA).....	237
<i>Keech v Sandford</i> (1726) SelCas Ch 61	54
<i>Kohn v Meehan</i> (2003) LTL All ER 315 (D)	51
<i>Kregor v Hollins</i> (1913) 109 LTR 225 (CA).....	101
<i>Kuwait Asia Bank EC v National Mutual Nominees Ltd</i> (1991) 1 AC 18.....	59, 143, 146
<i>Lagunas Nitrate Co v Lagunas Syndicate</i> [1899] 2 Ch 392	70
<i>Lee v Chou Wen Hsien</i> [1985] BCLC 45 (PC)	51
<i>Lister Romford Ice and Cold Storage Co Ltd</i> [1957] AC 555.....	61
<i>Lonrho v Shell Petroleum</i> (1980) 1 WLR 627.....	58, 60
<i>Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd</i> [1983] Ch 258	56, 58
<i>Mutual Life Insurance Co of New York v Rank Organisation Ltd</i> [1985] BCLC 11	212
<i>Norman v Theodore Goddard</i> [1991] BCLC 1028 (CD)	71

<i>North-West Transportation Co Ltd v Henry Beatty</i> (1887) 12 App Cas 589 (PC).....	53
<i>Overend Gurney & Co v Gibb</i> (1872) LR 5 HL 480	70
<i>Parke v Daily News Ltd</i> [1962] Ch 927.....	62, 234
<i>Percival v Wright</i> [1902] 2 Ch 421.....	56, 194, 196, 210, 214, 215, 216
<i>Peskin v Anderson</i> (2001) 1 BCLC 372 (CA)	57, 216
<i>Piercy v S Mills & Co Ltd</i> [1920] 1 Ch 77.....	53, 211
<i>Platt v Platt</i> (1999) 2 BCLC 745 (CD).....	57, 216
<i>Punt v Symons & Co Ltd</i> [1903] 2 Ch 506	53, 211
<i>R&B Customs Brokers Ltd v United Dominions Trust Ltd</i> (1988) 1 WLR 321	65
<i>Re a Company, Ex Parte Burr</i> [1992] BCLC 724 (CD).....	51
<i>Re Barings plc</i> (1999) 1 BCLC 433.....	72
<i>Re Brazilian Rubber Plantations and Estates Ltd</i> [1911] 1 Ch 425.....	70
<i>Re City Equitable Fire Insurance Company Ltd</i> [1925] 1 Ch 407 (CA).....	70, 71, 72, 115, 161, 162, 195, 276
<i>Re D' Jan of London Ltd</i> [1994] 1 BCLC 561 (CD).....	72, 115, 276
<i>Re Forest of Dean Coal Mining Company</i> (1878) 10 Ch D 450	70
<i>Re Horsley & Weight Ltd</i> [1982] 1 Ch 442 (CA)	58, 60, 229, 230, 232
<i>Re MDA Investment Management Ltd</i> (2004) 1 BCLC 217 (CD).....	59
<i>Re Produce Marketing Consortium Ltd</i> (No 2) [1989] BCLC 520 (CD).....	72
<i>Re Smith and Fawcett Ltd</i> [1942] 1 Ch. 304 (CA)	109, 141
<i>Re Westlowe Storage and Distribution Ltd</i> [2000] BCC 851	72
<i>Regal (Hastings) Ltd v Gulliver</i> [1942] 1 All ER 378 (HL).....	54, 210
<i>Regentcrest plc v Cohen</i> (2001) 2 BCLC 80 (CD)	51
<i>Rolled Steel Products (Holdings) v British Steel Corporation</i> [1985] 2 WLR 908 (CA)	53
<i>Russell v Northern Bank Development Corp Ltd</i> [1992] BCLC 1016 (HL)	138
<i>Standard Chartered Bank v Walker</i> (1992) 1 WLR 561	59
<i>Transvaal Lands Co v New Belgium Land and Development Co</i> [1914] 2 Ch 488	54, 139
<i>Vatcher v Paull</i> [1915] AC 372	109
<i>West Mercia Safetywear Ltd (in liq) v Dodd</i> [1988] BCLC 250 (CA).....	58, 60, 144, 145, 230, 232
<i>Winkworth v Edward Baron Development Co Ltd</i> [1987] 1 All ER 114 (HL) ...	58, 60, 144, 229, 230

<i>Yukong Line Ltd of Korea v Rendsburg Investments Corporation (No 2) (1998) 1 WLR 294</i>	59, 60, 145
---	-------------

NEW ZEALAND

<i>Benton v Priore</i> [2003] 1 NZLR 564 (HC).....	199
<i>Coleman v Myers</i> [1977] 2 NZLR 225 (SC).....	215, 216
<i>Manukau City Council v Lawson</i> [2001] 1 NZLR 599 (HC)	199
<i>Nicholson v Permakraft (NZ) Ltd</i> [1985] 1 NZLR 242 (CA).....	58, 60, 144, 145, 230, 232, 233
<i>Re Russley Hotel Ltd; Mattison & Anor v Gough & Ors</i> (2000) 8 NZCLC 26 (HC)	199

SOUTH AFRICA

<i>Anderson v Dickson NNO (Intermenua (Pty) Ltd Intervening)</i> 1985 (1) SA 93 (N)	222
<i>Ben-Tovim v Ben-Tovim</i> 2001 (3) SA 1074 (C)	212, 237
<i>Body Corporate of Greenwood Scheme v 75/2 Sandown (Pty) Ltd</i> 1999 (3) SA 480 (W)	223
<i>Ceramic Industries Ltd v NCBAWU</i> (1) (1997) 18 ILJ 716 (LC).....	261
<i>Clutchco (Pty) Ltd v Davis</i> 2005 (3) SA 486 (SCA)	286
<i>Coronation Syndicate Ltd v Lilienfeld and New Fortuna Co Ltd</i> 1903 TS 489	211
<i>Cronje NO v Stone</i> 1985 (3) SA 597 (T)	222
<i>Cyberscene Ltd v i-Kiosk Internet and Information (Pty) Ltd</i> 2000 (3) SA 806 (C)	208
<i>Dadoo Ltd v Krugersdorp Municipal Council</i> 1920 AD 530.....	217
<i>De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd</i> 1959 (3) SA 873 (O).....	37
<i>Dorklerk Investments (Pty) Ltd v Bhyat</i> 1980 (1) SA 443 (W)	222
<i>Du Plessis NO v Phelps</i> 1995 (4) SA 165 (C)	208
<i>Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd</i> 1980 (4) SA 156 (W)....	208, 211, 276
<i>Harri NNO v On-Line Management CC & Others</i> 2001 (4) SA 1097 (T).....	223

<i>Heneways Freight Services (Pty) Ltd v Grogor</i> 2007 (2) SA 561 (SCA)	222
<i>Hockey v Rixom</i> 1939 SR 107.....	226
<i>Janse van Rensburg NO v Minister of Trade and Industry</i> 2001 (1) SA 29 (CC)....	268
<i>L&P Plant Hire BK v Bosch</i> 2002 (2) SA 662 (SCA).....	223
<i>Lategan v Boyes</i> 1980 (4) SA 191 (T)	217
<i>Louw NO v DMA Fishing Enterprises (Pty) Ltd</i> 2002 (2) SA 163 (SE)	225
<i>LSA UK Ltd (formerly Curtainz Ltd) v Impala Platinum Holdings Ltd</i> (2000) SCA case number 222/98	237
<i>Magnus Diamond Mining Syndicate v Macdonald & Hawthorne</i> 1909 ORC	210
<i>McLelland v Hullett</i> 1992 (1) SA 456 (D)	215
<i>Novick v Comair Holdings Ltd</i> 1979 (2) SA 116 (W)	210
<i>Peens & Swart v MKTV Beleggings Beherend BK & Another</i> 2003 (3) ALL SA 426 (T)	264
<i>Philotex (Pty) Ltd v Snyman; Braitex (Pty) Ltd v Snyman</i> 1998 (2) SA 138 (SCA) 222	
<i>Pretorius v Natal South Sea Investment Trust Ltd</i> 1965 (3) SA 410 (W)	215
<i>Robinson v Randfontein Estates Gold Mining Co</i> [1921] (AD) 168	195, 210
<i>Rosebank Television & Appliances Co (Pty) Ltd v Orbit Sales Corp (Pty)</i> 1969 (1) SA 300 (T)	264
<i>Rousseau NNO v Visser</i> 1989 (2) SA 289 (C)	225
<i>RP Crees (PVT) Ltd v Woodpecker Industries (PVT) Ltd</i> 1975 (2) SA 485 (R)	217
<i>S v de Jager</i> 1965 (2) SA 616 (A)	35
<i>S v Goertz</i> 1980 (1) SA 269 (C).....	222
<i>S v Parsons</i> (1980) 2 SA 397 (D)	222
<i>Saincic and Others v Industro-Clean (Pty) Ltd and Another</i> [2006] JOL 17559 (SCA)	223
<i>Sage Holdings Ltd v The Unisec Group Ltd</i> 1982 (1) SA 337 (W).....	215
<i>Scharff's Trustee v Scharff</i> 1915 TPD 463	226
<i>Shell Auto Care (Pty) Ltd v Laggar</i> 2005 (1) SA 162 (D).....	208
<i>Sibex Construction (SA) (Pty) Ltd v Injectaseal CC</i> 1988 (2) SA 54 (T).....	208, 209, 210
<i>Swanee's Boerdery (Edms) Bpk (in Liquidation) v Trust Bank of Africa Ltd</i> 1986 (2) SA 850 (A).....	210
<i>Swerdlow v Cohen</i> 1977 (1) SA 178 (W)	220

<i>Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd</i> 2005 (5) SA 550 (SCA).....	208
<i>Terblanche NO v Damji</i> 2003 (5) SA 489 (C).....	222
<i>Wolpert v Uitzigt Properties (Pty) Ltd</i> 1961 (2) SA 257 (W) at 267.....	276

UNITED STATES OF AMERICA

<i>Aronson v. Lewis</i> 473 A.2d 805 Supreme Court of Delaware, 1984	103
<i>Dodge v Ford Motor Company</i> 170 N.W. 668 (Mich 1919)	7
<i>Federal Deposit Insurance Corp v Bierman</i> 2 F 3d 1424 (1993).....	163
<i>Francis v United Jersey Bank</i> 432 A 2d 814 (1981)	162

REPORTS

AUSTRALIA

Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors by the Senate Standing Committee on Legal and Constitutional Affairs (November 1989).

Corporate Practices and Conduct, Business Council of Australia, Melbourne, Information Australia (1991, 1993, 1995).

Hilmer Report

Hilmer Report: Strictly Boardroom: Improving Governance to Enhance Company Performance (1993) and (1998).

Bosch Report

Bosch Report: Corporate Practices and Conduct, Woodslane Pty Ltd 3ed (1995).

The Ramsay Report

Report by Professor Ramsay on Audit Independence (October 2001).

ASX's Best Practice Principles and Recommendations

The Australian Stock Exchange (ASX) Corporate Governance Council: Principles of Good Governance and Best Practice Recommendations (March 2003 and August 2007).

The HIH Report

The HIH Royal Commission: Report on the Failure of HIH Insurance (2003).

Standards Australia (Guidelines for Non-Listed Companies) (June 2003).

The Corporate Responsibility Report

The Report on Corporate Responsibility: Managing Risk and Creating Value by the Parliamentary Joint Committee and Corporations and Financial Services (June 2006).

Social Responsibility Report

The Social Responsibility Report of Corporations of the Corporations and Markets Advisory Committee (December 2006).

Final Report: Protecting the Worker's Interest in Enterprise Bargaining: The "No Disadvantage" Test in the Australian Federal Industrial Jurisdiction prepared for the Workplace Innovation Unit, Industrial Relations, Victoria by R Mitchell et al. (The Centre for Employment and Labour Relations Law, Law School).

Corporate Law Economic Reform Programme: Paper 1 Accounting Standards.

Corporate Law Economic Reform Programme: Paper 2 Fundraising.

Corporate Law Economic Reform Programme: Paper 3 Directors' Duties and Corporate Governance.

Corporate Law Economic Reform Programme: Paper 4 Takeovers.

Corporate Law Economic Reform Programme: Paper 5 Electronic Commerce.

Corporate Law Economic Reform Programme: Paper 6 Financial Markets and Investment Products.

Corporate Law Economic Reform Programme: Paper 7 Simplified Lodgement and Compliance Procedures with ASIC.

Corporate Law Economic Reform Programme: Paper 8 Cross-border Insolvency.

NEW ZEALAND

New Zealand Law Commission: Company Law Reform and Restatement No 9 of 1989.

New Zealand Law Commission: Company Law Reform: Transition and Revision No 16 of 1990.

Corporate Governance in New Zealand: Principles and Guidelines (2004).

SADC AND BOTSWANA

Protocol on Legal Affairs.

SADC Treaty

Southern African Community Treaty (1992).

SADC Programme

SADC Programme for Regional Harmonisation of the Accountancy Profession (1998).

The Interim Report

The Interim Report on the Review of the Botswana Companies Act (18 March 1999).

The Final Report

The Final Report on the Review of the Companies Act (3 November 1999).

SOUTH AFRICA

Van Wyk de Vries Commission

Kommissie van Ondersoek na die Maatskappywet Hoofverslag RP 45/1970 en Aanvullende Verslag en Konsepwetsontwerp RP 31/1972.

King I

King Report on Corporate Governance for South Africa, Institute of Directors in Southern Africa (November 1994).

King II

King Report on Corporate Governance for South Africa, Institute of Directors in Southern Africa (2002).

Executive Summary of King II

Executive Summary of the King Report on Corporate Governance for South Africa, Institute of Directors in Southern Africa (2002).

Consumer Credit Law Reform: Policy Framework for Consumer Credit (2004).

Policy Document

Department of Trade and Industry The Guidelines for Corporate Law Reform, South African Company Law Reform for a 21st Century (May 2004).

September 2005 NEDLAC Report

Preliminary Draft NEDLAC Report on Corporate Law Reform (September 2005).

February 2005 NEDLAC Report

NEDLAC Report on Corporate Law Reform (February 2005).

JSE Securities Exchange's Listing Requirements.

UNITED KINGDOM

Business and Society: Developing Corporate Social responsibility in the UK (URN 01/720) (2001).

Business and Society: Corporate Social Responsibility Report (URN 02/909) (2002).

Cohen Report

Cohen Report on Company Law Amendments (1945)

Corporate Social Responsibility: A Government Update (2004).

Law Society Company Reform

The Reform of Company Law, Law Society Legal Practice Directorate, No 255, Law Society (1991).

Law Society Company Reform

The Reform of the Law Society Legal Practice Directorate, No 225 (July 1991) London.

Cadbury Report

Report of the Committee on the Financial Aspects of Corporate Governance chaired by Sir Adrian Cadbury Gee and Co Ltd (1992).

Jenkins Report

Jenkins Report on Financial Reporting (1995)

Greenbury Report

Directors Remuneration Report: Report of a Study Group chaired by Sir Richard Greenbury (1995) Gee Publishing Ltd, London.

Law Commission 153, 105 Paper

Law Commission Paper No 153 Scottish Law Commission Discussion Paper No 105 "Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Directors' Duties" (September 1998).

Combined Code 1998

The Combined Code. Principles of Good Governance and Code of Best Practice (1998).

Hampel Report

Report of the Committee on Corporate Governance Final Report (1998).

Modern Company Law for a Competitive Economy (March 1998)

Law Commission 261 Paper

Law Commission and Scottish Law Commission “Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties” No. 261, SLC No 173 (1999).

The Strategic Framework

Modern Company Law for a Competitive Economy: The Strategic Framework, URN 99/654 (February 1999).

Modern Company Law for a Competitive Economy: Reforming the Law Concerning Overseas Companies (October 1999).

Modern Company Law for a Competitive Economy: Company Formation and Capital Maintenance (October 1999).

Modern Company Law for a Competitive Economy: Company General Meetings and Shareholder Communication (October 1999).

Developing the Framework

Modern Company Law Review for a Competitive Economy: Developing the Framework, URN 00/656 (March 2000).

Completing the Structure

Modern Company Law Review for a Competitive Economy: Completing the Structure, URN 00/1335 (2000).

Modern Company Law Review for a Competitive Economy: Capital Maintenance: Other Issues (June 2000).

Modern Company Law Review for a Competitive Economy: Registration of Company Charges (October 2000).

Modern Company Law Review for a Competitive Economy: Trading Disclosures (October 2000).

Final Report

Modern Company Law for a Competitive Economy: Final Report Volume 1 and 2
URN 01/942 and URN 01/943 (July 2001).

The White Paper 2002

Modernising Company Law: The White Paper (July 2002).

Combined Code 2003

Combined Code on Corporate Governance (July 2003).

Higgs Report

Review of the Role and Effectiveness of Non-Executive Directors by Derek Higgs
(2003).

Audit Committees Combined Code

Audit Committees Combined Code Guidance by Sir Robert Smith (January 2003).

The White Paper 2005

Modernising Company Law: The White Paper (March 2005).

Explanatory Notes on the Bill

Explanatory Notes on the Companies Bill [190].

Explanatory Notes on the Act

Explanatory Notes on the Companies Act of 2006.

OTHER REFERENCES

Burges Salmon Briefing (February 2007) on the United Kingdom Companies Act 2006.

Corporate Update of Ashurst of November 2006 on the United Kingdom Companies Act of 2006.

Corporate Update: Special Client Briefing (November 2006) by solicitors Clifford Chance on the United Kingdom Companies Act of 2006.

Document on directors' duties in terms of the United Kingdom Companies Act of 2006 drafted by Ben Quiney (Crown Office Chambers in London).

Notes on ministerial statements of the duties of directors in terms of the United Kingdom Companies Act of 2006 (June 2007).

OECD Principles of Corporate Governance (April 2004).

The Treaty on the European Union (Maastricht Treaty) O.J.C 191 of 29.7.1992.

FURTHER READING

Adams A *Law for Business Students* 3ed (2003) Pearson Longman.

Anderson ME et al. "Evaluating the Shareholder Primacy Theory: Evidence from a Survey of Australian Directors" University of Melbourne Legal Studies *Research Paper* 32.

Bainbridge SM "In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green" (1993) 50 *Washington and Lee Law Review* 1423–1447.

Batten JA, Fetherston TA (eds) *Social Responsibility: Corporate Governance Issues* (2003) JAI.

Bean GMD “Corporate Governance and Corporate Opportunities” (1994) 15 *The Company Lawyer* 266–272.

Bidin A “Corporate Law, Directors’ Duties and Creditor Protection” (1998) 19 *The Company Lawyer* 188–192.

Bone RG “Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness” (2003) 83 *Boston University Law Review* 485–552.

Bonollo F “The Nexus of Contracts and the Close Corporation Appraisal” (2001) 12 *Australian Journal of Corporate Law* 165–193.

Boraine A “Die Onderliggende Beginsels van die Insolvensiereg en Vernietigbare Regshandelinge Deel 2” (1996) 17 *Obiter* 213–237.

Boraine A “Die Ontwikkeling van die Leerstuk van Vernietigbare Regshandelinge in die Engelse Insolvensiereg Deel 1” (1997) 30 *De Jure* 75–97.

Botha D “The Changing Business of Business in South Africa: Some Comments on Developments in the Scope and Control of the Social Responsibility of Business in South Africa” (1994) 6 *South African Mercantile Law Journal* 90–96

Botha D, Jooste R “A Critique of the Recommendations in the King Report Regarding a Director’s Duty of Care and Skill” (1997) 114 *South African Law Journal* 65–76.

Cheadle H “Regulated Flexibility: Revisiting the LRA and the BCEA” (2006) 27 *Industrial Law Journal* 663–703.

Copp S “Corporate Governance: Change, Consistency and Evolution: Part 1” (2003) 14 *International Company and Commercial Law Review* 65–74.

Corfield A “The Stakeholder Theory and its Future in Australian Corporate Governance: A Preliminary Analysis” (1998) 10 *Bond Law Review* 213–240.

Crowther D *Managing Finance: A Socially Responsible Approach* (2004) Elsevier.

Davis T “Fiduciary Duties of Non-Executive Directors” (1984) *South African Law Journal* 567–578.

Dean J *Directing Public Companies: Company Law and the Stakeholder Society* (2001) Cavendish Publishing.

Dine J “Developments in Company Law in the United Kingdom: Formal Paralysis – But are Codes the Answer to Diversity?” (1998) *Tydskrif vir die Suid-Afrikaanse Reg* 304–315.

Flannigan R “The Adulteration of Fiduciary Doctrine in Corporate Law” (2006) 122 *Law Quarterly Review* 449–468.

Grantham RB “Recent Developments Concerning the Duties of Directors” (1988) November *New Zealand Law Journal* 403–407.

Griffiths S “Developing Corporate Governance Principles for New Zealand” (2004) 22 *Company and Securities Law Journal* 286–292.

Faure G, De Villiers CJ “Employee-Related Disclosures in Corporate Annual Reports and the King II Report Recommendations” (2004) 12 *Meditari Accountancy Research* 61–75.

Godfrey S, Maree J, Theron J “Regulating the Labour Market: The Role of Bargaining Councils” (2006) 27 *Industrial Law Journal* 731–752.

Goergen M “What do we know about Different Systems of Corporate Governance” (2007) 7 *Journal of Corporate Law Studies* 1–15.

Goldenberg P “IALS Company Law Lecture – Shareholders v Stakeholders: The Bogus Argument” (1998) 19 *The Company Lawyer* 34–39.

Hambidge EG, Luiz SM “Compromise and Personal Liability under Section 424 of the Companies Act: Two Judicial Approaches” (1991) 3 *South African Mercantile Law Journal* 123–128.

Harris B “Fiduciary Duties of Directors Under the Companies Act 1993” (1994) July *New Zealand Law Journal* 242–245.

Havenga MK “Company Law 2002” (2003) 11 *Juta’s Business Law* 68–72.

Hirani MH *The Company Law Related to Social Responsibility of Company Directors* (1997) A.P.H Publishing Corporation.

Kiarie S “At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value” (2006) 17 *International Company and Commercial Law Review* 329–343.

Kiel GC, Nicholson GJ “Board Composition and Corporate Performance: How the Australian Experience Informs Contrasting Theories of Corporate Governance” (2003) 11 *Corporate Governance: An International Review* 189–205.

Kumar A “Companies Act 2006: Directors’ Duty – A Governance v Legal Analysis” (2007) 90 *Business Law Bulletin* 6–7.

Lessing JPG “Company-law Reform in New Zealand” (1990) 2 *South African Mercantile Law Journal* 49–59.

Loose P, Griffiths MJ, Impey D *The Company Director: Powers, Duties and Liabilities* 8ed (2000) Jordans.

Lubbe DS “Die King-verslag en Belanghebbendes: ’n Nuwe Gedagte vir die Sakesektor?” (1996) 21 *Tydskrif vir Regswetenskap* 97–111.

Mammatt J, Du Plessis D, Everingham G *The Company Director’s Handbook* (2004) Siber Ink.

McLennan JS “Directors’ Fiduciary Duties and the Companies Act” (1983) 100 *South African Law Journal* 417–440.

Mongalo T “Shareholder Activism in the United Kingdom Highlights the Failures of Remuneration Committees: Lessons for South Africa” (2003) 120 *South African Law Journal* 756–766.

Mongalo T “Convergence of Traditional Corporate Governance and Modern Corporate Governance Reforms: Is King II *dejà vu* for Boards of Directors or is it a Set of New Principles?” (2004) 25 *Obiter* 79–90.

Njoya W “Employee Ownership and Efficiency: An Evolutionary Perspective” (2004) 33 *Industrial Law Journal* 211–241.

Ratner SR “Corporations and Human Rights: A Theory of Legal responsibility” (2001) 111 *The Yale Law Journal* 443–545.

Roestoff M, Renke S “Debt Relief for Consumers – The Interaction between Insolvency and Consumer Protection Legislation (Part 2)” (2006) 27 *Obiter* 91–110.

Rosedale C “Company Law (Australia)” (2006) 17 *International Company and Commercial Law Review* N33–N35.

Sadler P *Building Tomorrow’s Company: A Guide to Sustainable Business Success* (2002) Kogan Page.

Salant J “Effective Corporate Governance” (2003) 420 *De Rebus* 54–55.

Sandrock O, Du Plessis JJ “The German Corporate Governance Model in the Wake of Company Law Harmonisation in the European Union” (2005) 26 *The Company Lawyer* 88–95.

Schwarz F “The German Co-Determination System: A Model for Introducing Corporate Social Responsibility Requirements into Australian Corporate Law? Part 1” (2008) 23 *Journal of International Banking Law and Regulation* 125–133.

Sheikh S “Non-Executive Directors: Self-Regulation or Codification?” (2002) 23 *The Company Lawyer* 296–307.

Stapledon G, Webster J “Directors’ Duties and Corporate Governance” (2005) 23 *Company and Securities Law Journal* 205–208.

Sykes R “Directors’ Duties in the New Millennium” (2000) 21 *The Company Lawyer* 64–66.

Tilbury M “Why Law Reform Commissions?: A Deconstruction and Stakeholder Analysis from an Australian Perspective” (2005) 23 *The Windsor Yearbook of Access to Justice* 313–341.

Van Reenen TP “Reflections on the Codification of South African Environmental Law (1): General Considerations” (1994) 5 *Stellenbosch Law Review* 214–231.

Vettori S “A Judicially Enforceable Duty to Bargain?” (2005) 38 *De Jure* 382–394.

Wiener J *Globalization and the Harmonization of Law* (1999) Pinter.

Whincop MJ “The Role of the Shareholder in Corporate Governance: A Theoretical Approach” (2001) 25 *Melbourne University Law Review* 418–465.

INDEX

—A—

ASX's Best Practice Principles and Recommendations 127, 128, 131, 146, 148, 154, 164, 165, 166, 174

—B—

Bosch Report..... 130
business judgment rule..... 103, 163, 164, 170, 277

—C—

Cadbury Report..... 15, 24, 74, 75, 76, 77, 81, 240, 293
co-determination 147, 239, 240, 241, 242, 251, 252, 255, 256, 260
codification 13, 16, 48, 73, 81, 84, 88, 89, 91, 93, 95, 96, 97, 98, 107, 110, 111, 123, 124, 125, 126, 132, 158, 196, 197, 199, 200, 201, 202, 203, 204, 207, 286, 287, 290, 291, 293, 296, 297, 298, 302, 303, 304, 307, 308, 309, 313, 315
collective bargaining..... 150, 152, 156, 257, 258, 261, 262, 263, 264, 299, 321
Combined Code..... 74, 75, 76, 77, 78, 240, 283
communitaire theory 19, 25, 29, 30, 31, 40, 305
Completing the Structure.. 43, 61, 83, 87, 88, 89, 94, 95, 104, 105, 106, 111, 201, 292
comprehensive codification 97, 132, 196, 200, 202, 292, 314
concession theory..... 25, 29, 30, 33, 40, 305
consumers 2, 8, 18, 22, 38, 41, 51, 56, 57, 64, 65, 66, 67, 68, 93, 142, 157, 159, 166, 181, 213, 224, 252, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 275, 276, 278, 282, 289, 290, 299, 302, 303, 304, 307, 310, 312, 314, 316, 319, 321, 323
contractual theory 27, 31, 305
Corporate Responsibility Report 10, 127, 128, 131, 148, 153, 155, 156, 157, 161, 166, 174, 178, 180, 312
corporate social responsibility 5, 6, 7, 8, 9, 11, 31, 175, 177, 178
creditor protection..... 68
creditors 2, 4, 13, 18, 26, 29, 32, 33, 37, 39, 49, 55, 56, 57, 58, 59, 60, 65, 67, 68, 80, 92, 95, 108, 119, 120, 124, 141, 142, 143, 144, 145, 146, 167, 171, 181, 197, 199, 212, 213, 216, 217, 218, 219, 220, 221, 222, 223, 224, 225, 226, 227, 228, 229,

230, 231, 232, 233, 234, 253, 264, 265, 266, 276, 288, 289, 290, 299, 300, 302,
303, 304, 306, 307, 309, 310, 312, 314, 319, 321, 322

—D—

Developing the Framework 43, 61, 83, 86, 87, 89, 93, 94, 95, 96, 97, 98, 99, 101, 102,

103, 104, 105, 106, 110, 201, 292, 308

disadvantages of codification..... 292

duty of care and skill 2, 42, 70, 72, 98, 104, 106, 110, 115, 134, 161, 162, 163, 195,
276

duty of good faith..... 2, 42, 51, 52, 104, 172, 194

duty to act for a proper purpose 52, 109

duty to avoid conflicts..... 110, 112, 115, 116, 134

—E—

employees 2, 4, 10, 13, 14, 18, 21, 22, 32, 33, 34, 35, 37, 38, 39, 41, 51, 55, 56, 57,
61, 62, 63, 64, 68, 69, 80, 93, 95, 100, 109, 114, 118, 119, 120, 121, 122, 140, 142,
146, 147, 148, 149, 151, 152, 153, 154, 155, 156, 160, 167, 174, 181, 213, 221,
227, 234, 235, 238, 239, 240, 241, 242, 243, 246, 247, 249, 251, 252, 253, 255,
256, 257, 258, 259, 261, 262, 263, 264, 265, 278, 286, 288, 289, 290, 294, 299,
302, 303, 304, 306, 307, 309, 310, 312, 314, 315, 316, 317, 319, 320, 321

English rules of equity 15, 50

enlightened shareholder value approach 3, 33, 34, 40, 69, 84, 88, 90, 91, 92, 93, 94,
95, 109, 111, 119, 125, 156, 161, 178, 180, 251, 252, 254, 260, 280, 281, 282, 284,
285, 287, 289, 301, 305, 307, 309, 311, 315

—G—

general law duties 132, 133, 146

Germany 6, 147, 239, 240, 241, 242, 245, 246, 247, 248, 249, 251, 252, 255, 257, 264

Greenbury Report 15, 74, 76, 79, 81, 125, 308

—H—

Hampel Report 15, 73, 74, 75, 76, 78, 79, 80, 82, 125, 308

harmonisation 16, 47, 183, 184, 185, 186, 187, 191, 192, 200, 202, 203, 204, 207,
304, 313

Hilmer Report 130

—J—

Jenkins Report 215

—K—

King Reports . 16, 34, 242, 251, 254, 277, 281, 283, 289, 290, 293, 301, 304, 314, 315

—M—

management board 187, 239, 241, 242, 244, 247, 248, 249, 250, 252

—N—

New Zealand 16, 58, 59, 132, 144, 146, 165, 185, 189, 191, 192, 196, 198, 199, 200,
201, 202, 203, 215, 217, 228, 230, 291, 292, 293, 302, 304, 313

—P—

Paper 3 of CLERP 131, 146, 159, 169, 172

partial codification 13, 16, 81, 96, 97, 132, 198, 202, 203, 207, 286, 290, 292, 297,
314, 315

pluralist approach 3, 33, 34, 35, 40, 86, 90, 91, 92, 94, 125, 251, 252, 277, 284, 305,
308

Policy Document 1, 3, 4, 11, 12, 13, 15, 16, 33, 34, 180, 185, 205, 206, 207, 211, 240,
251, 253, 254, 255, 257, 277, 284, 285, 286, 287, 289, 291, 296, 301, 304, 314,
315

proposed theory 26, 38, 39, 142, 227, 256, 263, 289, 306, 318, 323

—S—

SADC Treaty 182, 183, 187

secret profit 54, 97, 106, 195, 297

self-regulation 290, 292, 294

separate legal entity 11, 22, 23, 38, 39, 41, 91, 141, 142, 157, 211, 213, 217, 227, 263,
275, 289, 306, 316, 318, 319, 323

shareholder value 3, 18, 25, 33, 35, 56, 86, 90, 91, 92, 95, 102, 107, 120, 125, 147,
152, 166, 172, 177, 179, 215, 251, 277, 279, 280, 283, 284, 289, 305, 308, 315

shareholders 1, 2, 3, 4, 5, 6, 7, 8, 10, 11, 13, 16, 18, 20, 21, 22, 23, 24, 25, 28, 29, 31,
32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 46, 48, 50, 52, 53, 55, 56, 57, 58, 61, 63, 68,
69, 74, 76, 78, 79, 80, 86, 87, 88, 89, 90, 92, 93, 94, 95, 101, 103, 107, 109, 111,
120, 121, 122, 123, 125, 126, 132, 136, 139, 141, 142, 143, 145, 146, 147, 150,
156, 159, 160, 161, 165, 166, 167, 171, 173, 174, 175, 176, 177, 178, 180, 186,
189, 194, 196, 197, 199, 200, 201, 208, 211, 212, 213, 214, 215, 216, 217, 220,
221, 224, 227, 228, 230, 231, 234, 235, 236, 241, 243, 244, 245, 247, 249, 250,
251, 252, 253, 256, 265, 278, 279, 280, 281, 282, 284, 285, 286, 287, 288, 289,

290, 294, 298, 299, 300, 302, 303, 304, 306, 307, 308, 309, 311, 312, 313, 314, 315, 316, 318, 319, 321, 322	
<i>Social Responsibility Report</i>	5, 127, 131, 153, 154, 178, 179
stakeholder model	14, 19, 147, 171, 172, 252, 281, 282
stakeholders2, 3, 4, 5, 6, 7, 9, 10, 11, 13, 14, 16, 17, 18, 19, 20, 21, 22, 23, 25, 26, 27, 31, 32, 34, 37, 38, 39, 40, 41, 43, 51, 55, 56, 61, 63, 65, 68, 69, 73, 74, 80, 81, 84, 89, 90, 91, 92, 93, 94, 95, 107, 109, 111, 112, 120, 121, 123, 124, 125, 128, 141, 142, 146, 147, 153, 154, 155, 157, 159, 160, 161, 164, 165, 166, 167, 169, 171, 172, 173, 174, 175, 176, 177, 178, 180, 181, 201, 202, 203, 213, 224, 227, 234, 238, 251, 252, 253, 255, 256, 260, 263, 267, 274, 276, 277, 278, 279, 280, 281, 282, 283, 284, 286, 287, 289, 294, 298, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319, 321, 323	
statutory duties1, 108, 118, 124, 132, 133, 180, 195, 199, 200, 201, 202, 208, 290, 292, 293, 298, 311, 315	
<i>Strategic Framework</i>	60, 83, 85, 86, 88, 90, 92, 93, 95, 96, 97, 98, 106, 115, 308
supervisory board51, 239, 241, 242, 243, 244, 245, 246, 247, 248, 249, 250, 252, 255, 257	
—T—	
theories on the nature of a company	19, 25, 33, 40, 303, 305, 306
Treaty of Rome	47
triple-bottom line	3, 11, 24, 155, 172, 254, 279, 280, 281, 283, 285, 298, 315
two-tier board6, 147, 239, 240, 242, 246, 250, 251, 252, 254, 255, 256, 260, 263, 299, 321	
—U—	
<i>ultra vires</i>	47, 62, 192, 245
unitary board147, 235, 239, 240, 249, 250, 251, 252, 253, 254, 255, 256, 257, 263, 299, 321	
—W—	
<i>White Paper 2005</i>	15, 106, 201